BANK OF NAMIBIA

8th ANNUAL SYMPOSIUM PUBLICATION 2006

"THE ASSESSMENT OF FOREIGN DIRECT INVESTMENT VERSUS DOMESTIC INVESTMENT IN NAMIBIA"

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ANNUAL SYMPOSIUM 2006

THE ASSESSMENT OF FOREIGN DIRECT INVESTMENT VERSUS DOMESTIC INVESTMENT IN NAMIBIA

Edited by the Research Department

Citations should refer to the Annual Symposium 2006 of the Bank of Namibia. The views expressed are those of the author(s) and do not necessarily represent those of the Bank.

Published by The Research Department of the Bank of Namibia
P O Box 2882
Windhoek
NAMIBIA

ISBN: 99916-61-36-0

http://www.bon.com.na

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Preface and Overview

PREFACE

The 8th annual symposium of the Bank of Namibia was held on September 20th, 2006 at the NamPower convention centre in Windhoek under the theme, "The assessment of Foreign Direct Investment versus Domestic Investment in Namibia". The impact of foreign direct investment (FDI) on domestic economies has been a subject matter of lively debate in economic policy circles in recent years. It is argued that FDI allows the transfer of technology, particularly in the form of capital inputs which cannot be achieved through financial investments or trade in goods and services. It can also promote competition in the domestic input market. Recipients of FDI often gain employee training and skills in the course of operating new business, which contributes to human capital development in the host country.

On the other hand, some economists have controversially argued that FDI absorption by countries may be a sign of some of its institutions' weakness rather than their strengths. This is because at a given level of macroeconomic fundamentals, such as an expanding market or low labor costs, whether a country get more or less FDI relative to domestic investments depends on the relative competitiveness of foreign firms versus domestic firms. Against this background, the objective of the symposium was to assess the potential impact of FDI on the Namibian economy. Furthermore, the symposium aimed at evaluating the question of whether FDI in Namibia has been promoted at the expense of domestic investment as well as attempting to answer the issue of whether there is a deliberate policy biased towards the promotion of FDI vis-à-vis that of domestic investment in Namibia. The symposium also attempted to answer the concern of why should Namibia rely so much on FDI whereas it could retain local savings and translate them into productive investment and therefore realize a higher rate of economic growth.

The event was addressed by three prominent speakers; Professor Slyvanus Ikhide, Associate Professor of Economics at the University of Namibia, Dr. Oluyele Akinkugbe, Senior Lecturer in Economics at the University of Botswana and Mr. Robin Sherbourne, an Independent Economist, based in Windhoek, Namibia.

OVERVIEW

In his welcoming remarks the Deputy Governor of the Bank of Namibia, Mr. Paul Hartmann underlined that the theme of the symposium is certainly not a straightforward subject with easy solutions. He further indicated that the choice of the theme emanated from the fact that Namibia is able to attract considerable FDI while local institutional investors experience difficulties in finding suitable investment opportunities. Consequently, there is an apparent important paradox in foreign capital flows. As a note of caution he pointed out that the Bank of Namibia did not expect the symposium to conclude that Namibia should do away with FDI and replace it with domestic capital investment, but, hoped that the symposium would shed light on the anomaly mentioned and offer suggestions on how more locally generated savings can be channelled into local investments.

The first symposium paper titled 'review of foreign direct investment and domestic investment: the experience of developing countries' was presented by Professor Ikhide. The paper argued that the majority of developing countries face low domestic capital formation and therefore expect FDI to significantly contribute to domestic investment and enhance economic growth. The paper however, pointed out that the results of research studies on the impact of FDI on domestic investment and economic growth in developing economies has rather been mixed. In some countries, FDI has contributed significantly to domestic investment and economic growth while in others; FDI has actually crowded out domestic investment. In the case of Namibia, the paper noted that the country has witnessed a rapid increase in FDI inflows in the past decade when compared to other African countries and the expectation that FDI should complement domestic investment has been partially realised. Nonetheless, the translation of this result to accelerated economic growth has been slow. Consequently, the paper suggests that in addition to the magnitude of FDI inflows, the quality and nature of FDI, the creation of favourable economic policies and the cultivation of a pool of skilled labour are some of the key ingredients that the country must put in place to benefit from the favourable inflow of FDI.

Dr Akinkugbe presented the second paper titled: 'Measuring the benefits and costs of FDI in Namibia'. The paper underscored the important role of FDI as a source of private capital for developing countries as argued by various international agencies such as the United Nations Conference on Finance and Development (FfD), the Cotonou Partnership Agreement, the New Partnership for Africa's Development (NEPAD), as well as the United Nations Millennium Declaration.

The paper argued that despite the benefits that accrue from FDI in the forms of employment, export growth, technology spillover as well as sustained industrial and economic diversification, countries need to take into account the costs that may be associated with FDI inflows. Such costs entail amongst others; deterioration in the balance of payments caused by the repatriation of profits, lack of positive linkages with local communities, potentially harmful environmental impact of especially extractive and heavy industries, social disruptions of accelerated commercialisation etc. Although the economic benefits of FDI are real and in most cases outweigh the costs; they do not accrue automatically. Consequently, the paper recommended various policy measures that Namibia should implement to achieve the desired level of economic growth and development. The recommended policies include; the promotion of local resource based industries, support for export orientated industries, broadening the scope of the tourism sector in terms of both geographical location as well as products on offer, negotiation and entry into force of manufacturing agreements with selected major South African manufacturers, establishment of a small-scale industrial centre to provide and enhance information and skills required by the small scale industries, and the engagement of the Government of Namibia into the process of indicative planning.

The main issues that emanated from Dr. Akinkugbe paper's were discussed by Mr. Rainer Ritter, Chief Executive Officer of the Namibia Financial Institutions Supervisory Authority. In his evaluation, Mr. Ritter fully acknowledged that the paper is very comprehensive and informative, given the information that was available to the author. He further took cognisance of the fact that the paper stated the data limitations and acknowledged the weaknesses of the cost benefit analysis conducted by the Research Department of the Bank of Namibia.

The discussion paper argued that good policy can only be based on good information and therefore recommended that more empirical research need to be done to better guide policy making in Namibia in the future. The importance of institutional quality to economic growth was emphasised in the paper. In this regard, the discussion paper noted that FDI is unlikely to deliver significant growth and development effects, especially if it natural resource seeking and the developing country has not achieved a given level of development. On the areas of improvement, it was pointed out that Namibia needs to improve its international rankings as a country particularly in the following areas; starting a business, registering property, protecting investors etc. The paper recommended that the Government of Namibia's role should be to formulate appropriate policies to ensure that "value" flows into national development, irrespective of the origin of the investment.

The final paper titled: 'strategies to promote foreign direct investment in Namibia' was presented by Mr.Robin Sherbourne. Similar to the first two papers, he noted that FDI is crucial in complementing domestic savings and is in most cases accompanied by skills and technology to the local economy. He further noted that the importance of FDI equally apply to developed as much as it does to developing countries. The paper noted that Namibia's sixteen years of independence also provide ample evidence that FDI has been an important ingredient in the country's economic success story.

A number of strategies which the Government of Namibia could implement to boost FDI were outlined. These strategies entail; securing property rights, improving market access, creating a clear and competitive system of taxation, providing skilled and productive labour, working towards the free flow of capital, constructing world class infrastructure, eliminating corruption, cultivating a positive international image and producing credible and timely information.

Mr. David Nuyoma, Chief Executive Officer of the Development Bank of Namibia critically assessed the paper presented by Mr. Sherbourne. The discussion paper concurred with the paper by Mr. Sherbourne that FDI has played an important role in contributing to sustainable economic growth in Namibia. He however, pointed out that the paper could have provided a brief statistical review on the Namibian economy as well as include an analysis of the role of domestic investment in the economy. The discussion paper explicitly argued that the importance of domestic investment in the Namibian economy should not be downplayed and underestimated. In this regard, it highlighted the fact that domestic investment has a better appreciation for local conditions and is therefore not as easily swayed to disinvest. Moreover, it was observed in the paper that retained earnings from domestic investment tend to be reinvested more in the Namibian economy relative to FDI. The paper concluded by proposing that an Investment Advisory Council that would advice the Minister of Trade and Industry and Government on issues of investment promotion in the country be established.

Welcoming Remarks By Mr. Paul Hartmann, Deputy Governor Of The Bank Of Namibia

Director of Ceremony

Board members of the Bank of Namibia

Honourable Members of Parliament

Members of the diplomatic corps

Eminent speakers and discussants

Members of media

Distinguished guests

Ladies and Gentlemen

It is with great pleasure that I welcome you all to the eighth in the series of Bank of Namibia Annual Symposia. First of all, allow me to extend my warm greetings to our invited guest speakers and discussants. We are quite privileged to have one guest speaker in the area of foreign direct investment from the University of Botswana, Dr. Oluyele Akinkugbe. We are equally fortunate to have two eminent local speakers who are proficient in the theme of this symposium and also very familiar with the various challenges facing the Namibian economy. They are Prof. Sylvanus Ikhide from the University of Namibia and Mr. Robin Sherbourne, an independent economist. To our discussants and invited guests, let me thank you for honouring our invitation for this rather important event of national importance.

The theme for this year's symposium "The Assessment of Foreign Direct Investment versus Domestic Investment in Namibia" is certainly not a straightforward subject with easy solutions. The choice for this theme stems from the fact Namibia is able to attract considerable foreign direct investments. At the same time, however, local institutional investors experience difficulties in finding suitable investment propositions. To illustrate this point, over the last five years FDI inflows amounted to N$2.0 billion, while capital outflows stemming mainly from portfolio investments amounted to N$4.8 billion over the same period. This clearly is a significant paradox in foreign capital flows. I want to make it quite clear, however, that we do not expect this symposium to conclude that we should do away with FDI and replace it with domestic capital investment. But, we certainly hope that this symposium will shed light on why we experience this anomaly and what net gains these two sources of investment capital bring about and how they can complement each other.

We also expect the speakers to acknowledge that FDI has both benefits and costs for developing countries, such as Namibia. For instance, the experience of a small number of fast-growing East Asian newly industrialized economies has strengthened the belief that attracting FDI is the key to bridging the resource gap of low-income countries. In this regard, FDI is viewed as a major stimulus to economic growth in developing countries. This view is particularly derived from the ability of FDI in dealing with two major obstacles, namely, addressing shortages of financial resources caused by small, shallow and illiquid financial markets, as well as addressing the lack of the required technology and relevant skills.

On the other hand, we also anticipate our speakers to recognise a number of bottlenecks that inhibit FDI from being a vehicle to stimulate economic growth in developing economies. Such drawbacks include the institutional weaknesses of developing economies to fully absorb FDI and the competitiveness problems of domestic firms vis-à-vis foreign firms. Moreover, it is worth noting that the benefits of FDI do not accrue automatically and evenly across countries, sectors and local communities. Thus, the nature and design of national policies matter for attracting FDI to developing countries and for reaping the full benefits of FDI for development. This implies that host countries, including Namibia, need to establish a broad, transparent and effective enabling policy environment for investment (both foreign and domestic) to be able to spur economic growth, create employment and thereby reduce poverty. Moreover, it is also of utmost importance to build formidable human and institutional capacities to implement such policies so as to enhance the net welfare gains to the society.

In the context of Namibia, the country generates an excess of domestic savings that is by far not fully translated into domestic investment. On the other hand, the country has adopted the Foreign Investment Act of 1990, which provides for favourable investment and tax incentives to attract foreign investment. In this context, two questions are arising: (a) is there a deliberate policy bias towards the promotion of FDI at the expense of domestic investments in Namibia; and (b) should we not put more emphasis on creating a healthy enabling environment for local and foreign investors instead of expecting Government to express a preference for one of the two sources of investments? It is against this background that the Bank has chosen this theme for this year's symposium with a view to providing answers to some of these questions and to forge the way forward for the promotion of investment and economic growth in the country.

With these few remarks, I welcome you all to this year's symposium and wish you very fruitful deliberations. I am confident that we will have an enriching and stimulating debate on these vital issues in the course of today.

I thank you

Opening Remarks By Ms. Bernadette Artivor Executive Director Of The Namibia Investment Centre

Director of Ceremony,

Mr. Paul Hartmann, the Deputy Governor of the Bank of Namibia

Honourable members of Parliament

Other Distinguished and invited Guests

Ladies and Gentlemen,

I am distinctly honoured and privileged to have been invited to deliver an opening remark at this prestigious event, and share quality time with a distinguished audience. While this is not my first presence at the Bank of Namibia Annual Symposium, I am extremely happy today, to address your annual event in my capacity as the Executive Director of the Namibia Investment Centre (NIC). As you all know, the Namibia Investment Centre is Namibia's National Investment Promotion Agency.

My role is to present Government's perspective on "ASSESMENT OF FOREIGN DIRECT INVESTMENT AND DOMESTIC INVESTMENT IN NAMIBIA". The other distinguished people seated on the podium will make presentations on specific aspects related to the issue under discussion.

Director of Ceremonies, while browsing through the background papers, I came across a number of questions relevant to the theme of this symposium. Some of the questions are quite fundamental and worth looking at closely. I will, however, not be able to dwell on all of them in a speech of fifteen minutes.

Allow me, nevertheless, to raise just five of these fundamental issues:

(i) Does Namibia need FDI to achieve its desired level of growth and development?

(ii) Is FDI beneficial to Namibia?

(iii) Has FDI come to Namibia at the expense of the promotion of domestic investments, and is there a deliberate policy strategy towards the promotion of FDI vis-? -vis to domestic investment in Namibia?

(iv) Why should Namibia rely comparatively more on FDI while it could retain local savings and realize the desired level of economic growth by translating such savings into productive investment?

(v) What about policy change toward improving the overall investment climate?

Director of Ceremonies, foreign investment is, indeed, a crucial component of a successful economic future for Namibia and its people. Companies from abroad who choose to invest here generate wealth for Namibia. It is a fact that a high gross investment capital and capital formation level is necessary for achieving high economic activity and growth rate. Foreign Direct Investment is necessary to supplement or complement domestic investment leading to a high capital formation and economic activity and growth. This in turn is expected to enhance the capacity of the local economy to generate the much needed positive direct and indirect benefits for the country.

Firstly, and most obviously, a foreign company which builds a factory or sets up some other form of business creates jobs for local people. These are jobs which if not for the foreign investor, would not exist. At one end of the scale are large investors in terms of capital invested like Ramatex and Anglo Base Metals who employ thousands of otherwise unemployed Namibians at their respective locations in Windhoek and Rosh Pinah.

On the other end there are much smaller businesses like, say, a tourist resort or a German-owned jewellery workshop which may only employ just a few people, but all are equally important for a country with an unemployment rate of 35 percent, where every single job created counts greatly for the employed, his extended family and the economy at large.

Secondly, foreign companies contribute towards the development of requisite technical and managerial skills through exposure to machinery, skilled foreign workers, technological processes and practices, which are then learned by the local people whom they employ. This means that Namibian people develop expertise which they can use to their own advantage in the labour market and to most importantly contribute to productivity and economic growth for the country as a whole.

Thirdly, foreign companies invariably consume goods and services from local or other enterprises in the country thus stimulating growth of such enterprises. A large foreign investor may require packaging materials or engineering, cleaning, transport, banking, insurance, utility and security services from one or a number of local service providers. In addition, Namibian enterprises can form joint ventures with foreign investors which may afford them a great opportunity to gain access to new technologies, new markets and management skills, as well as additional capital.

Fourthly, foreign investment can help to raise the level, content and value of what we already export. If, instead of selling just the raw materials overseas, we can supply consumer-ready locally value added products based on those materials, then the overall value of the country's exports increases.

Director of Ceremonies, let me briefly provide some figures on investment inflows into Namibia for the past five years. In 2001, investment flows into Namibia totalled a historical record of some N$4.85 billion, creating 10,900 new jobs. The most significant projects were the announcement of the N$1 billion investment to establish the Ramatex textile plant in Windhoek and the implementation of the N$3.2 billion investment by Anglo Base Skorpion Zinc mining and refinery at Rosh Pinah. These investments confirmed the success of the Namibian Government's policies and efforts to attract Foreign Direct Investment (FDI) and fast track the country's industrial transformation.

Other notable investments recorded during that year include:

- the N$100 million investment by Bank Windhoek into one of Namibia's most modern shopping centres, Maerua Mall in Windhoek.
- the N$95 million investment by Namcot Diamonds into a diamond cutting and polishing centre in Windhoek; and
- the N$60 million investment by the South African retail group, Trade Centre, into a leading department store in Windhoek

However, the situation has changed dramatically from the 2001 scenario in the ensuing year of 2003 in which only N$546 million investments were realized, deteriorating further in 2004 and 2005. Whereas the NIC projected to facilitate FDI commitments of over N$1.5 billion and N$2 billion for the 2004 and 2005 years, it could only garner N$202.39 million (2004) and N$620 million (2005). These figures only reflect that part of FDI which were handled by the NIC/Offshore Development Company network, and not investments that find its way into the country through other means and rather than our formal system. Moreover, most or over 70 percent of the Foreign Direct Investment in Namibia, from 2001, throughout to 2005 have been in the mining and related value addition sectors. For example, the opening of LLD Diamonds Namibia by the Lev Leviev Group in 2004, Hard Stone Processing (diamond cutting and polishing), the Langer Heinrich Uranium project, and the Omaruru Namibia Stone Processing company (marble and granite).

In addition to reinvestments by existing mining companies such as Namdeb, Ongopolo, Rössing Uranium, leading lodges and so forth. Government, and by implication the NIC, will continue to promote investment in activities that citizens cannot initiate, either alone or at all, owing to lack of capital, technical know-how, production management or marketing experience.

Director of Ceremonies, on the question of FDI vs. domestic investment, I neither believe that FDI has come to Namibia at the expense of the promotion of domestic investments, nor that there is any deliberate policy in Namibia biased towards the promotion of FDI as opposed to domestic investment. Namibia has put in place the required institutions, policy and legal frameworks conducive for not only attracting FDI, but also for encouraging domestic investors and promotion of the development of the private sector.

The promotion of both domestic and FDI remains a high priority of Government. To demonstrate this, I would like to quote from NDP II: *“Both domestic and foreign investments into the economy are required to increase the level of gross fixed investment and capital formation without which the growth in the county’s production and export sectors cannot be realised. It is from such investments that economic growth and diversification as well as high levels of employment creation and increased income can be realised”.*

Furthermore, Director of Ceremonies, in order to boost the flow of long term investment into the economy, with particular emphasis on new investment in secondary and tertiary sectors, Government has put in place the special incentives for manufacturers and Exporters aimed at reducing the cost of manufacturing and boosting export capacity. These entails tax relief to eligible investors and exporters of manufactured goods. Another important policy instrument that has been adopted and has helped in attracting both domestic and especially foreign investment into the country is the Export Processing Zones regime. In this connection while the majority of the EPZ enterprises are undoubtedly foreign-owned, some enterprising Namibians have also taken advantage of the generous incentives offered under the EPZ regime.

The EPZ is a policy instrument that forms part of our overall industrial and export development strategy. Through this legislative framework, the Government is seeking to expand the country's manufacturing and export base through a set of incentives aimed at reducing the high cost involved in manufacturing and accessing the highly competitive regional and world markets. Numerous benefits have accrued from the investors who have been admitted under the EPZ regime. I have mentioned most of these earlier.

Director of Ceremonies, in its ongoing commitment towards promoting domestic investment and indigenous business entrepreneurship, the Government has not only made considerable efforts in adopting policies and programmes and directing public investment into the SME sector, but also in mobilising private sector participation in the SME development. In 2000, the Government adopted the Small Business Development Policy and Programme which saw the setting up of a Credit Guarantee Fund that enabled budding SME operators to access capital financing from commercial banks.

Government has also put in place the SME sites and premises development programme through which industrial and general business premises such as modern markets sites, industrial stalls and technology demonstration centres are constructed and leased to SME operators on affordable bases. To date there are 31 sites and premises made up of industrial parks, SME modules, common facility centres and slaughter houses.

The programmes mentioned above are aimed at:

- Reducing the cost of SME business set up;
- Boosting indigenous business development, income and job creation by the SME sector, and
- Improving the share contribution of the SME sector to the country's GDP;

Government has invested in the development of all these facilities to induce local entrepreneurs to partake in the local economy and contribute to its growth and development, diversify their business activities and become tomorrow's multinational corporations.

Director of Ceremonies, the surplus of domestic savings over investments is largely exported to the Republic of South Africa (RSA), taking advantage of the free mobility of capital between the two countries owing to the Common Monetary Area (CMA) arrangement. Plans are underway at policy level which are aimed towards transforming these savings into domestic investment.

The existence of an enabling environment is a key consideration for private Investment. In this regard, we need to continually assess the effectiveness of our strategies, incentives and administrative systems and private investment. We equally need to take stock of the contribution of such investment to our economy as we are going to do here today.

On policy change towards improvement of the overall investment, I am glad to announce that this symposium is taking place on the eve of the "Namibia Investment Climate and Incentives Reform Project", which the Ministry of Trade and Industry has commissioned the World Bank's Foreign Investment Advisory Services (FIAS) and the Multilateral Investment Guarantee Agency to conduct. This is underpinned by the Government's recognition of Namibia's shortcomings in terms of attraction of FDI, and stimulation of local investment. Moreover, last year we have conducted an audit of the investment climate in the country called the investor roadmap study with the assistance of the USAID funded Southern Africa Trade Hub based in Gaborone, Botswana. All these efforts points to the need for us as a country to continually work towards creating and maintaining an attractive business and investment climate.

Director of Ceremonies, the primary mandate of the Government and the Ministry of Trade and Industry in particular is the transformation of the content and character of our economy through industrialization. Increased investment into Namibia is needed to further stimulate economic growth, create employment, introduce new technologies, develop new export markets and create market opportunities for our growing SME sector.

Foreign investment is one of the World's most sought after commodities. Almost every country is trying to attract it, including those prosperous nations such as the United States, Germany and the Untied Kingdom, who are themselves major outward investors. The prime motive for investment, especially private investment, is explained by the quotation below:

"The language of foreign investment is money (profits)"

The quotation above emphasizes the fact that an investment will only be made if the investor concerned is sure that he/she will make a financial return on that investment. The investment climate in Namibia is relatively still good on the general. But recent studies by the World Bank and the Africa Competitiveness Report indicate a drop in Namibia's world and regional ranking as a competitive business and investment location. So as we discuss and take stock of the role of FDI and domestic investment, it is also equally and even more important for us to take stock of our competitiveness as an investment destination. It is important to point out that the attractiveness and competitiveness of Namibia as one of the many potential investment destinations is dependent not only on Government and its policies but also on other key stakeholders such as indigenous private sector, the work force and trade unions and the entire Namibian civil society.

In light of the above therefore, my expectation is that at the end of the symposium we would have not only taken stock of the progress that we have made but more importantly chart out a roadmap on how we are going to regain our competitive ranking as well as increase and retain both domestic and foreign direct investment, which we critically need to move our economy forward to realizing our set national development goals of Vision 2030.

As we deliberate, I would specifically like us to recognize the factors that influence the decision for an investor to invest in a given location. These include:

- Financial considerations – return on investment requirements
- Skills availability
- Taxation (competitive tax rate)
- The business and regulatory climate
- Markets and market potential
- Political stability
- Employment legislation and trade unions activity
- Corporate legislation

- Property
- The availability of suitable partners
- Quality of life

I thank you

REVIEW OF FOREIGN DIRECT INVESTMENT (FDI) AND DOMESTIC INVESTMENT: THE EXPERIENCE OF DEVELOPING COUNTRIES

BY

PROFESSOR SYLVANUS I. IKHIDE

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ABSTRACT

From a background of low domestic capital formation, developing countries naturally expect FDI to contribute substantially to domestic investment and hence enhance economic growth. The results have been mixed. While in a few countries this expectation has been met, the results from a large number of countries are quite the contrary. In some of these countries, FDI has actually crowded out domestic investment. Namibia has witnessed a rapid increase in FDI inflows in the past decade when compared to other countries in Africa. The expectation that FDI should complement domestic investment has been partially realised. However, the translation of this result to accelerated economic growth has been slow. In addition to the magnitude of FDI inflows, this paper suggests that the quality and nature of FDI, conducive economic policies and the cultivation of a pool of skilled labour are some of the ingredients that the country must put in place to benefit from the current favourable inflow of FDI that it currently enjoys.

1. Introduction

Virtually all developing countries today make a strong claim on the role of FDI in economic growth and development. Although FDI flows to this group of countries are small in absolute terms, they can, it is argued, nonetheless, constitute a significant proportion of the overall capital formation[1]. It is not surprising therefore that many of them offer considerable opportunities for additional investment. FDI usually flows as a bundle of resources including besides capital, production technology, organisational and managerial skills, marketing know-how, and sometimes market access through the marketing networks of multinational

[1] In 2003, FDI inflows to developing countries as percent of total world inflows was put at 31 percent. Out of this, Asia alone accounts for about 62.2 percent while Africa accounts for only 8 percent.

enterprises, (MNEs) that undertake FDI. In many cases, these skills tend to spill over to domestic enterprises in the host country.

UNCTAD (2000) reports that from 1979 to 1999, the ratio of world FDI stock to world gross domestic product rose from 5 percent to 16 percent and the ratio of world FDI inflows to global domestic capital formation rose from 2 percent to 14 percent. This would tend to imply that an increasing share of countries' output is accounted for by foreign affiliates of multinational firms (Haskiel at al, 2002). However, the spate of empirical evidence in the past couple of years has not demonstrated the same enthusiasm for developing countries. When developing countries offer incentives to multinational firms to induce local affiliate production under these assumptions, a lot of caution and rethink is called for.

Our goal in this paper is to review the evidence on the linkage between FDI inflows and domestic investment in developing countries. We will attempt to review some of the traditional channels through which FDI affects or crowds out (in) domestic investment. Thereafter, we will provide evidence on available studies in developing countries especially Africa. Given available evidence, we will examine the implication of our findings for Namibia and highlight possible policy alternatives for the economy.

This paper is divided into six sections. After a brief introduction, section 2 revisits the theoretical underpinnings on the relationship between FDI, domestic investment and growth in developing countries. Section 3 examines the trends in FDI growth in Namibia in relation to other SADC countries. In section 4, we draw on available empirical work to show broad correlations between FDI inflows and domestic capital formation with special emphasis on Namibia. On the basis of our findings, we draw some policy implications for Namibia in section 5 and finally in section 6 we summarise our main conclusions.

2. FDI, Domestic Investment and Economic Growth

2.1 Basic theoretical conceptualisations

The impact of FDI on the standards of living and prospects for economic growth of developing countries has been a subject of much debate in recent years. The theories behind FDI and growth revolve around their role in providing badly needed additional capital in capital-scarce developing economies and access to technology and know-how as well as access to international markets. These assets are germane for economic growth and development and for better integrating developing countries into the global markets.

The beneficial and malign conceptualisation of FDI[2]

Two alternative conceptualisations of the impact of FDI underline an understanding of its potential contribution to the economic development of host countries (Moran, 1998). The beneficial conceptualisation of FDI emphasises the net addition of inputs that foreign investors may bring to a domestic setting that is highly competitive. The argument runs that FDI may help the host country to break out of the vicious cycle of underdevelopment – low levels of productivity which leads to low level of wages, low level of saving, low level of investment, which perpetuate low level of productivity.

FDI by complementing low domestic saving and supplying more effective management, marketing, and technology to improve productivity can help break this cycle. Assuming reasonably competitive conditions, FDI it is argued, could raise efficiency, expand output, and lead to higher economic growth.

The malign model of FDI and development has two strands. First, the possibility exists that foreign investors have the capability to thwart the passage of laws that constrain socially undesirable practices-such as pollution regulations, or health, safety, and minimum wage requirements-or ignore laws already in place. Aside from this, there is also the direct concern with the possible negative impact of FDI on economic growth. Here it is argued that foreign companies operate in industries where there are substantial barriers to entry, enjoying and even increasing an already bad situation, i. e. the absence of domestic competition. This tendency towards increase market concentration will worsen rather than improve the domestic savings situation. As foreign firms extract rents and siphon off capital through preferred access to local capital markets and local supplies of foreign exchange, rather than close the gap between investment and foreign exchange, they might drive domestic producers out of business and substitute imported inputs.

The malign model and competition in FDI

Theory and evidence indicate that the malign model tends to have an upper hand in many developing countries. The structure and modus operandi of FDI is anti-competitive. FDI thrives on barriers to entry and imperfect competition. Traditional

2 See Moran 1998 for fuller exposition.

analysis postulate that for firms to operate outside their own home economy, they must possess some sort of specific advantages (control over technology, proprietary rights to brand names, economies of scale realised by operating in more than one country, organisational and managerial expertise etc.) over rival firms in other national economies. Thus, FDI originates in international industries where there are high barriers to entry and employs itself in domestic markets in the developing countries where there are high degrees of concentration.

The presence of multinationals in natural resource industry and the oligopoly they create in many developing countries is explained by the barriers to entry advantage possessed by foreign firms. At the production stage, there are often barriers to entry, deriving from scale, capital intensity, technology of exploration and exploitation, and the organisational demands for managing large-scale engineering operations. The costs involved in large scale operations especially at initial stages rule out developing countries from effectively exploiting their natural resources thus forcing them to be more dependent on foreign firms.

One area where such adverse impact of FDI has been very pronounced is in terms of the negative externalities generated by the superior positioning of MNEs in developing countries which enables them to acquire domestic enterprises. Mergers and Acquisitions (M&As) constitute the predominant form of MNE expansion into foreign markets about 57 percent of FDI inflow in 2002 was in the form of M&A (UNCTAD, 2003). In the case of acquisition, foreign entry could affect domestic investment in the industry adversely by its entry raising conduct. It is argued that MNE affiliates with their arsenal of intangible assets such as internationally known brand names, captive access to technology and reservoirs of technical, managerial and organisational skills, are likely to pursue anti-competitive modes of rivalry to maximise their profits. With their emphasis on product differentiation and other modes of non-price rivalry, (Kumar, 1990, 1991), entry of new domestic firms to the industry is impeded by the 'contrived entry barriers'. In doing this, MNEs may 'crowd-out' domestic firms and investment.

Evidence supports the fact that imperfect competition is pervasive in FDI. There is a strong correlation between high concentration ratios and outward investment for industries in countries like the USA, UK, France, Germany, Sweden and Japan. Outward investment is found in industries with large economies of scale, and high advertising and technology intensity. Developing countries economies that receive FDI (especially in manufacturing and trade) also show a high correlation between market imperfections and FDI. The possibility that FDI, apart from important specific harmful activities, might lead to fundamental economic distortion and pervasive damage to the development prospects of the host country remains one of the sour points of FDI promotion.

However, these same characteristics of imperfect competition tend to suggest that FDI may feature rents (including high profits and high wages) access to privately controlled activities (including technology, marketing, and best management practices) and potential spillovers and externalities that could be of high value to host countries. The popularity of endogenous growth models with its emphasis on the role of knowledge or technology as a factor of production has heightened expectations on the role of FDI in developing countries in recent years. By bringing new knowledge to their host countries, MNEs may help to reduce “idea gaps” between developed and developing countries which are sources of growth (Romer, 1993).

This coexistence of high private returns to MNEs and potential beneficial social returns to host economies constitute the nexus around which the gains from FDI are often analysed in developing countries. But the role of competitive conditions in host-country economies is pre-requisites for the harnessing of these benefits of FDI. And this raises the question:” Will policies or incentives that create a buffer for FDI companies stimulate competition”? The granting of exclusivity to foreign firms as a form of FDI incentive means that foreign firms are able to exercise market power in the market in question. Granting privileged market position to MNEs may harbour hidden costs. Evidence abound in most empirical research to show that competition determines the extent to which hosts benefit or suffer from the presence of foreign firms. With a perspective for FDI that highlights the possibility of substantial dangers as well as huge opportunities, countries must of necessity focus on the design of policies that encourage competition in attracting foreign investors (Simana, 2005).

2.2. FDI and crowding in of domestic investment

Crowding in/out of domestic investment by FDI

At the core of the debate on FDI and growth is that FDI does not only contribute to capital accumulation but also crowds in domestic investment. FDI’s effect on growth would be more favourable than domestic investment if it crowds in more domestic investment than it crowds out. Often it is difficult to separate efficiency gains from spillovers emanating from FDI from the crowding in effect of FDI. No doubt, by increasing the productivity and efficiency of local firms, efficiency spillovers can help to stimulate domestic investment. However, crowding-in effect of FDI investment may occur in the absence of technology spillovers or in the absence of substantial cooperation with domestic inputs such as labour. For instance, local assemblies which serve only to put together components manufactured elsewhere may still drive domestic investment and growth through increases in local demand. Another often cited example is the preponderance of resource based FDI in developing countries. This group of multinationals heavily concentrated in mining no doubt contribute significantly to domestic capital formation and hence economic growth. However, it is doubtful whether the efficiency spillovers from them are effective.

On the other hand, MNEs may undermine local savings and crowd–out domestic investment by competing in product, service and financial markets and displacing firms. The loss of domestic firms can undermine market competition, leading to inflated prices and lower quality products. Domestic investment can also be compromised if macro-level policies to attract foreign capital (such as high interest rates) raise the domestic cost of capital. In the long-run, successful FDI policies may enhance foreign exchange earnings. However, the risk remains that it may lead to crisis in the balance of payments by repatriating profits and by increasing the rate of imports faster than the rate of exports. Taken together, FDI could lead to an overall contraction, rather than an increase in domestic investment or economic growth. What is the available evidence on FDI and domestic economic growth? We summarise some of the main results in Table 1 on the next page.

Attempts at providing an aggregate net assessment on the contribution of FDI to economic growth in developing countries have been conflicting. There are three main conclusions that can be reached from these studies. First, FDI may have a clear positive impact on development. There are benefits that well structured FDI projects can provide to host country development. In a study of 58 developing countries, including several in Africa, Bosworth and Collins (1999), finds that FDI brought a “one for one increase in domestic investment” compared to other types of private finance (Jenkins, 2002).

Second, FDI can have a substantial negative impact on development (so negative that the host community would be better-off not receiving the FDI at all). For instance, the monopolistic tendencies of MNEs may crowd out domestic investment (Gardiner, 2000). The possibility that FDI may “crowd out” domestic firms and result in a contraction in total industry size and/or employment has also been highlighted

Table 1. Does FDI Promote Economic Growth in Developing Countries?

Study Author(s)	Year	Yes, No, Mixed	Key Variables
Balasabrumayam, Salisu and Sapsford	1996 1999	Mixed	Trade regime must be open or neutral
Borenstein, Gregorio and Lee	1998	Mixed	Depends on education level of workforce
Graham and Wada	2001	Yes	Raised per capita GDP in Chinese provinces with FDI concentration
Graham	1995	Mixed	MNE's market power can generate negative impacts
de Mello	1999	Mixed	Depends on degree of complementarity and substitution between FDI and domestic investment
Fry	1992	Mixed but significantly negative	Immiserizing. FDI crowds out domestic investment
Blomstrom et al	1994	Mixed	Depends on country's absorptive capacity
Lal and Streeten (UNCTAD)	1977	Mixed (mostly negative 60 percent)	Competitiveness of sales
Lensink and Morrissey	2001	Yes	Reduces costs of R&D and promotes innovation
Loungani and Razin	2001	Mixed	Risks
Lim	2001	Mixed	Depends on tax incentives, regulatory and legal impediments, Macro-economic instability
Marino	2000	Mixed	Open trade and investment policies
Mallampally and Sauvant	1999	Mixed	Human resource development, information and other infrastructure
Markussen and Venables	1999	Yes	Raises productivity and exports of domestic firms; generates spillovers
Rodrick	1999	No	Reverse causality: TNCs locate, rather than drive growth, in ore productive and faster growing countries.
Wells	1986	Mixed (mostly positive 50-75 percent)	Competitiveness of the markets
Agosin and Mayer	2000	Positive for Asian countries, negative for Latin America and neutral for Africa	FDI crowds in domestic investment.
Pradharn	2002	Mixed though significantly negative	Host country policies

Source: Gallagher and Zarsky (2004); Alfaro and Rodigruez-Clare (2003)

(Cobham, 2001; Jacobs, 2001). This position maintains that FDI can do irreversible damages to host country development.

Third, most studies would tend to confirm that the extent to which FDI will affect host country's economic development will depend on a number of factors, chief among which are the ability of host country to stimulate or retard competition where foreign investors are located, the development threshold of the host country, the openness of the economy, the effectiveness of domestic industrial, tax, macroeconomic and financial policies etc.

2.3. Efficiency spillovers and domestic investment

Apart from the ability of FDI to crowd out or crowd in domestic investment, a second major avenue through which FDI can impact on domestic investment is via improvement in productivity through knowledge spillovers. MNEs invest overseas both by buying existing companies and productive capacity (mergers and acquisitions) and by creating new ones usually through the creation of local affiliate (greenfield). MNEs have some distinctive assets such as technology, global marketing capacities, and management skills which domestic firms do not have. The firm is therefore able to earn a "rent", and the host country, other things equal, gets "spillover" benefits of the superior assets. Dubbed the contagion effect, efficiency spillovers resulting from the transfer of technologies and management practices raise the efficiency, productivity and marketing skills of domestic firms.

Horizontal Spill-overs

Two main channels for the occurrence of efficiency spillovers have been identified. The first is the so-called horizontal spillovers. This can occur via three main conduits: demonstration, competition and labour turn-over. Demonstration effects or knowledge spillovers occur through the copying of the technology of MNEs operating in the local market-the so-called imitation or "learning by watching effect". Here, there may be no formal training but spillovers occur through on the job training, learning by doing or learning by observing. The inducement of competition in the host country market occasioned by the entry of MNEs could force local firms to use their existing resources more efficiently or to search for new technologies (Blomstroom and Kokko, 1998, Kokko, 1994). Under increased competition, domestic firms are forced to operate more efficiently and introduce new technologies earlier than what would have been the case. Moreover, multinationals can create spillover effects on domestic production through the channel of labour turn-over. This effect occurs when workers employed in foreign affiliates who have been trained with advanced technical and managerial skills move to other domestic firms or open their own enterprises, a concept dubbed “spin-offs” in the literature (Forsfuri, 1996).

There is substantial evidence that multinationals undertake remarkable efforts in the education of local workers (Forsfuri, Motta and Ronde, 2001). Multinationals also offer more training to technical workers and managers than do local firms (Gershensberg, 1987, Chen, 1983). Studying the case of Taiwan, (Pack, 1997) finds evidence that trained managers often leave MNEs to create their own firms and that labour mobility from MNEs to domestic firms is important. Thompson (2003) found sufficient evidence on horizontal spillovers by Hong Kong’s cross-border garment firms in the transfer of so called soft technology to China.

The limitation on the effectiveness of horizontal spillovers rest on the fact that as domestic firms tend to compete with MNEs, MNEs in turn might unwittingly embark on policies that tend to shield technology leakage and halt spillovers. This is done in most cases through the formal protection of intellectual property, trade secrecy, paying higher wages or locating to countries or industries where domestic firms have limited imitative capacities to begin.

Vertical Linkages

By far, the most important form of spillover efficiency in the context of developing countries is the linkage between MNEs affiliates and their local suppliers. Often referred to as vertical linkages, such spillovers occur when MNEs are suppliers (forward linkages) or buyers (backward linkages) of domestic firms. For instance, MNEs may help prospective suppliers set up production facilities, demand that suppliers meet high quality standards and develop capacities for product innovation and provide training for them to do so, provide training in business management, help suppliers find additional markets, including in sister affiliates in other countries[3], and boost demand for intermediate products thus allowing local suppliers to reap the benefits of scale economies. Thus, MNEs can help local firms break the market constraints to acquiring increased returns by boosting demands, which leads to efficient production. FDI can also contribute to technology improvement of their domestic suppliers by offering technical assistance and supports to these firms.

3 Competition effect may set in when multinationals acquiring domestic firms choose to source intermediates abroad thus breaking existing supplier-customer relationships and increasing competition in the intermediate products markets.

Literature has attempted to identify factors that drive vertical spillovers. It is argued that the motivation for undertaking FDI is likely to affect the extent of local sourcing by foreign affiliates (UNCTAD, 2000; Belderbos et al, 2001). Foreign affiliates that produce for the domestic market tend to purchase more locally than export-oriented ones for the simple reason that quality and technical requirements associated with goods targeted for the domestic market may be lower and thus local suppliers may find it easier to serve multinationals focused on the local market. It has also been argued affiliates established through M&As or joint ventures are likely to Source more locally than those taking on greenfield projects. The latter might take time to develop local cleavages, whereas the former can take advantage of the supplier relationship by the acquired firm or other local partners. This has also touched on the issue of ownership. To the extent that full ownership is a proxy for greenfield projects, we expect that fully-owned foreign affiliates may rely more on imported inputs, while investment projects with local capital participation will tend to Source more locally. Thus, backward linkages associated with the latter group are likely to result in greater spillovers. Since these kinds of vertical spillovers occurs in the interaction between foreign and domestic firms not in the same industry, it is also referred to as inter-industry spillover as distinct from the horizontal effects often styled intra-industry spillover.

The evidence on whether FDI generates spillovers and the conditions under which they do it is again split. For developed countries, studies have shown that the productivity of domestic firms is positively correlated with the presence of foreign firms (Haskie et al, 2003). For developing countries, there is no consensus. Some studies have found clear evidence of spillover effects, while others have found limited or sometimes outright negative effects. We again summarise our main findings in Table 2.

Table 2. Does FDI Generate Spillovers in Developing Countries?

Author(s)	Sample	Results	Explanation
Aitken, Hanson and Harrison (1999)	Venezuela (1976-1989)	No evidence of spillovers, small net impact of foreign investment on domestic firms	There could be positive effect of foreign equity participation as well as improved exports of domestic firms
Blomstrom and Wolff (1989)	Mexico (1965 -1984)	Found evidence of knowledge spillovers	Evidence of increasing convergence of the productivity levels of locally owned firms to that of foreign-owned firms
Haddad and Harrison) (1993	Morocco (1985 -1989)	Reject the hypothesis that foreign presence accelerated productivity growth in domestic firms	However, estimation may be faulty. Did not fully control for simultaneity
Kokko, Zejan and Tansini (2001) Kokko (1998)	Uruguay (1988) Mexico	Positive spillovers from FDI to a sub-sample of local manufacturing plants; presence of foreign firms catalysed exports	Results from the two studies confirm that spillovers from foreign firms depend sub-stantially on local capability in the industry
Amsdem and Chu (2003)	Taiwan	Positive spillovers	Government policy played a crucial role
Graham (1995)	Cross country study	Found overwhelming evidence of positive spillovers	
Krugman (1998)	East Asia	Negative spillover	Superior cash position rather than efficiency enhancing technology more crucial
Moran (1998)	Mexico	Maybe	Found ample evidence of positive spillovers from FDI in the auto industry. However, absence of liberal investment climate to encourage vertical integration
Borensztein, De Gregario, Lee (1998)	FDI flows into 69 LDCs (1970-1979; 1980-1989)	Positive/negative spillovers	FDI contributes to growth only when host country has a minimum threshold stock of human capital

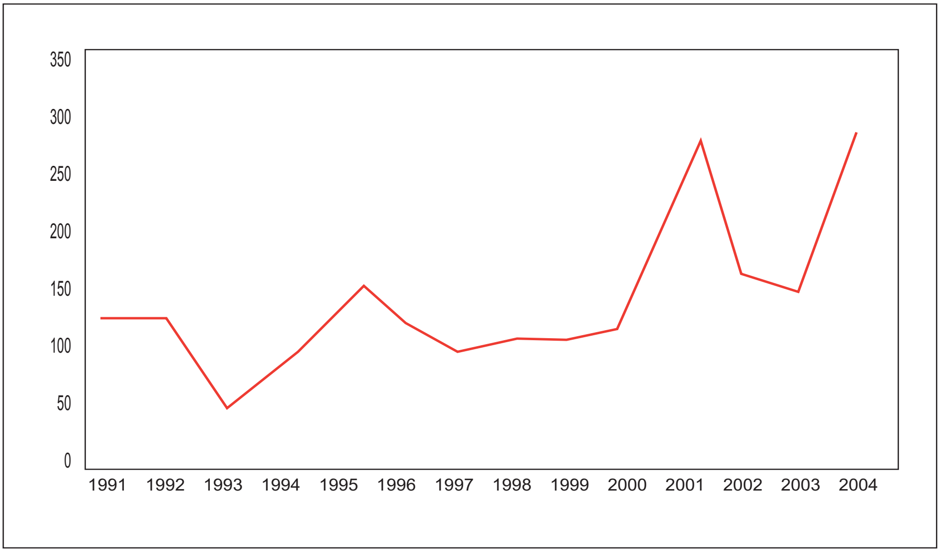
Source: Gallagher and Zarsky (2004); Alfaro and Rodigruez-Clare (2003)

The evidence available suggests that there is no automatic or consistent relationship between FDI and efficiency spillovers. A country's ability to realise the promise of FDI to transfer technology and diffuse knowledge depends on conducive policy, institutional factors and market environment.

3. Trends in FDI in Namibia

This section starts with a review of some developments in FDI growth in Namibia. After gaining independence in 1990, Namibia opened its borders to FDI. However, it did not receive large FDI inflows till the late 1990s. As Fig 1 shows, Namibia did not receive any substantial FDI inflows till around 1997. Viewed against the performance of many of the countries in Africa, Namibia's effort at attracting FDI has been quite substantial rising from an average of 13.1 percent between 1995-99 to 38.6 percent in 2004 after hitting a peak of 51 percent in 2001.

Figure 1. FDI Inflows into Namibia in US$ (1991-2004)



Namibia's FDI as a ratio of GCFC is higher than the average for Southern Africa, Africa and the developing economies. A major Source of this increase is in increased equity capital and reinvested earnings (BoN, 2004). This in itself is traceable to the sustained efforts of Government at creating a more business-friendly environment after the lost decades of apartheid. The creation of the Namibia Investment Centre has paid off handsomely in the promotion of the country as a profitable investment destination in the past couple of years.

Table 3. Overview of FDI Inflows in Namibia (Millions of US$ and percentage)

FDI FLOWS (Inward flows)	1985-1995 (Annual Average)	2001	2002	2003	2004
Namibia	73	365	181	149	286
percent of GFCF	13.1	53.0	32.4	15.8	38.6
Southern Africa*	137	7264	1460	**1267**	**1038**
percent of GFCF	1.7	35.9	7.7	4.2	2.7
Africa	3584	20027	12994	18005	18090
percent of GFCF	4.0	20.7	13.0	15.0	12.5
Developing Economies	49868	217845	155528	166377	233227
percent of GFCF	4.6	12.9	9.5	8.8	10.5
World	182438	825925	716128	632599	648146
percent of GFCF	3.8	12.0	10.6	8.3	7.5

Source: UNCTAD

*Southern Africa consists of Botswana, Lesotho, Namibia, Swaziland and South Africa

In terms of cumulative FDI inflows per GDP, Namibia's performance is quite outstanding both at the continental and regional level (Table 4). FDI stocks accounted for over a third of GDP in Namibia except for the slight decline in 2003. This supersedes the performance at the Southern African level, the African performance and the average developing economy performance.

Table 4. Trends in FDI stocks in Namibia

FDI stocks	1980	1990	2000	2003	2004
FDI stock	1935	2047	1230	1241	1527
As percent of GDP	83.8	80.9	35.6	27.1	32.6
Southern Africa	19437	12996	47379	49370	50596
As percent of GDP	22.8	10.9	34.2	28.3	21.9
Africa	40126	59445	151246	200240	219277
As percent of GDP	10.2	12.7	26.5	27.8	26.4
Developing Economies	132044	364057	1734543	2001203	2225994
As percent of GDP	5.4	9.8	26.2	27.8	26.4
World	530244	1768589	5780846	7980317	8895279
As percent of GDP	5.0	8.4	18.3	22.0	21.7

Source: UNCTAD

The picture for Namibia is brought out more clearly in Table 5 where we highlight the trends in FDI against developments in GFCF and gross domestic savings. Although both GCFC and gross domestic savings ratios have increased substantially over the years, the FDI inflows as a ratio of GDP has not demonstrated the same trend. We will return to this development shortly.

Table 5. Gross fixed capital formation, Foreign Direct Investment and gross domestic saving in Namibia (1990-2005)

Years	FDI/GCFCR	FDI/GDPR	GFCF/GDP	GDS/GDP
1990	0.204323	0.809000	0.204017	0.135806
1991	0.281477	0.787000	0.155499	0.152802
1992	0.191961	0.759000	0.202082	0.231515
1993	0.085832	0.524000	0.211460	0.232101
1994	0.147630	0.492000	0.195255	0.277773
1995	0.192431	0.480000	0.221706	0.286558
1996	0.132778	0.427000	0.235494	0.257678
1997	0.129581	0.435000	0.196252	0.224722
1998	0.108356	0.425000	0.229963	0.254125
1999	0.136897	0.416000	0.230130	0.222926
2000	0.211527	0.356000	0.188265	0.249219
2001	0.342335	0.252000	0.219353	0.242433
2002	0.315009	0.379000	0.211620	0.278868
2003	0.130471	0.271000	0.291561	0.333166
2004	0.207341	0.326000	0.253522	0.327539
2005	0.204323	0.303000	0.266120	0.314572

Source: National Income Accounts (Central Bureau of Statistics) and UNCTAD (WIR) various issues.

Where;

FDI/GFCFR-Foreign Direct Investment flows as ratio of Gross fixed capital formation

FDI/GDPR-Foreign Direct Investment stocks as ratio of GDP

GCFC/GDP-Gross fixed capital formation as ratio of GDP

GDS/GDP-Gross domestic saving as ratio of GDP

From Table 6, it would be observed that whereas most countries in Sub-Sahara Africa need FDI to plug their saving-investment gap, this is not the case for Namibia, Botswana and to some extent, South Africa. Therefore, the major reason for the campaign for FDI in Namibia must be sought outside the conventional beneficial conceptualisation argument.

Table 6. Gross fixed capital formation, Gross Domestic saving, FDI, (as percent of GDP) and GDP growth rate in SADC (1990-02)

Countries	Gross formation	Capital	Gross saving	Domestic	Resource gap	FDI	GDP growth rate
Angola	13.4		19.3		5.9	5.7	0.4
Botswana	26.0		33.7		7.7	0.3	4.3
DRC	7.0		8.5		1.5	0.0	-5.1
Lesotho	57.2		-39.4		-96.8	13.9	4.4
Malawi	17.3		3.0		-14.3	1.3	3.8
Mauritius	28.3		24.0		-4.3	0.8	5.1
Mozambique	19.8		-6.6		-26.4	2.7	6.2
Namibia	20.7		21.0		0.3	3.3	3.4
Seychelles	31.5		22.3		-9.2	6.8	3.3
South Africa	14.8		17.6		2.8	0.6	1.9
Swaziland	24.8		21.7		-3.1	5.3	3.1
Tanzania	21.4		1.8		-19.6	5.3	3.1
Zambia	14.1		7.1		-7.0	3.5	0.2
Zimbabwe	19.7		16.9		-2.8	1.3	2.8

Source: Adapted from Jenkins (2003)

Tables 7-10 give some indication of Namibia's performance relative to other SADC members during the period 1990-2004. In terms of absolute size of FDI inflows, Namibia may not have matched the performance of Angola, South Africa and Tanzania, but it has been remarkably consistent in attracting inflows. Except for the slight dip in 2002, FDI inflows have shown a steady increase since 1990. Its share of total SADC inflows rose from barely 1.7 percent in 1996 to about 5.6 percent in 2004. When it is realised that the SADC region has performed better than any other region in Africa at attracting FDI in recent years (UNCTAD, 2001), the relative performance of Namibia can be placed in context.

Table 7. FDI Inflows in SADC (Millions of US$)

Countries	1990-9 Average	1996	1997	1998	1999	2000	2001	2002	2003	2004
Angola	260	181	421	1114	2471	879	2146	1672	3505	2048
Botswana	-24	70	100	96	37	54	26	405	418	47
DRC	-3	25	-44	61	11	23	1	117	158	900
Lesotho	213	286	32	27	33	31	28	21	42	52
Malawi	15	44	-1	-3	46	-33	-20	6	10	16
Mauritius	21	37	55	12	49	277	32	33	70	65
Mozambique	28	73	64	235	382	139	255	348	337	132
Namibia	96	129	84	77	111	153	275	181	149	286
Seychelles	23	30	54	55	60	56	59	48	58	60
South Africa	301	818	3817	561	1502	888	6789	757	720	585
Swaziland	63	22	-15	152	100	39	78	90	61	69
Tanzania	39	149	158	172	517	463	327	430	527	470
Zambia	122	117	207	198	163	122	72	82	172	334
Zimbabwe	34	81	135	444	59	23	4	26	30	60
Total SADC	1188	2062	5067	3201	5541	3114	10072	4216	6257	5124
Total Africa	9139	5622	7153	7713	8971	8198	8700	20027	12994	18005
Namibia as percent of Africa	1.2	1.8	1.0	0.8	0.9	1.7	1.3	1.3	0.8	1.5
Namibia as percent of SADC	8.0	6.2	1.7	2.4	2.0	4.9	2.8	6.5	2.4	5.6
Namibia as percent of Southern Africa	14.8	9.7	2.1	8.4	6.2	13.1	3.8	12.4	10.7	27.5

Source: Goldstein 2003; UNCTAD, 2005

Namibia also ranks very high in SADC when FDI inflows are placed in relation to gross fixed capital formation. South Africa which used to account for over 65 percent of the total stock of SADC FDI in the 1990s has been losing ground in recent years to countries like Namibia, Botswana, Angola and Tanzania. It currently accounts for a little lower than 55 percent. After the initial plunge in the early 1990s, Namibia's stock as a percentage of total SADC FDI has increased gradually from 1.1 percent in 2001 to about 1.8 percent in 2004. Namibia has succeeded in avoiding the boom and bust cycles that has characterised FDI flows in other SADC countries. For instance the huge inflows into South Africa in 2001 are accounted for by the unbundling of cross-shareholding between the London-listed Anglo American and DeBeers of South Africa (Goldstein, 2003).

Table 8. FDI Stocks (Millions of US$)

Countries	1980	1985	1990	1995	2000	2001	2002	2003	2004
Angola	61	675	1024	2621	7977	10122	11435	14001	17349
Botswana	698	947	1309	1126	1821	1494	1946	1986	1982
DRC	709	620	546	541	617	618	650	974	1874
Lesotho	5	25	83	179	330	358	382	427	479
Malawi	113	151	198	163	183	163	163	363	379
Mauritius	26	43	169	256	687	719	746	822	887
Mozambique	15	17	42	202	1094	1350	1697	2034	2166
Namibia	1994	2010	2047	1708	1230	797	1092	1241	1527
Seychelles	54	105	204	321	577	636	690	748	808
South Africa	16519	9024	9121	15099	47418	50246	50998	48125	46283
Swaziland	243	104	336	535	432	479	656	853	926
Tanzania	47	91	93	325	1783	2111	2351	3038	5203
Zambia	355	450	1012	1543	2350	2422	2619	2985	3019
Zimbabwe	186	187	124	342	1085	1088	1114	1185	1204
Total SADC	21025	14149	16308	25261	67584	72603	76492	78782	84086
Namibia as percent of SADC	9.4	14.2	12.6	6.8	1.8	1.1	1.4	1.5	1.8
Namibia as percent of Southern Africa	10.2	16.5	15.8	9.2	2.4	1.5	1.5	2.4	3.0

Source: Goldstein 2003; UNCTAD, 2005.

While these indicators might be useful, they do not take into account the different sizes of host countries and therefore they make intercountry comparison difficult. UNCTAD has developed an original approach to capture the effect of factors other than size that determine the willingness of foreigners to invest in a country. UNCTAD's FDI Performance Index is the ratio of a country's share in global FDI flows to its share in global GDP. When the measure takes a value lower than one, it signals a country's inability to attract its fair share of global FDI, whether due to weak governance, an unpromising location and/or a poor endowment of physical and human infrastructure. The opposite is the case when the value exceeds one. Recently, UNCTAD has improved on this index by benchmarking a country's performance against eight factors considered key determinants of transborder flows. As a measure of Namibia's performance we report below the FDI performance and potential performance index using this measure.

Table 9. UNCTAD Inward FDI Performance and Inward Potential Performance Index

	Value			Rank			Score (0-1)			Rank		
	1988 1990	1999 2001	2002 2004	1988 1990	1999 2001	2002 2003	1998 1990	1999 2001	2001 2003	1998 1990	1999 2001	2001 2003
Angola	-0.0	5.1	10.1	129	2	4	0.151	0.166	0.170	105	105	76
Botswana	2.2	0.3	2.2	29	115	41	0.297	0.346	0.187	41	59	65
DRC	-0.1	0.2	3.6	134	127	20	0.097	0.085	0.031	131	139	140
Malawi	1.1	1.0	0.3	51	133	119	0.150	0.203	0.084	106	120	133
Mozambique	0.3	1.8	3.4	109	24	23	0.068	0.178	0.137	137	108	98
Namibia	0.5	0.9	2.8	94	34	32	0.164	0.279	0.154	98	79	86
South Africa	-0.0	0.2	0.2	131	81	126	0.220	0.266	0.176	67	72	73
Tanzania	0.1	0.6	2.5	119	40	36	0.120	0.161	0.100	122	130	126
Zambia	4.2	1.7	2.4	9	64	38	0.111	0.160	0.077	124	134	136
Zimbabwe	-0.2	0.8	0.3	136	124	113	0.152	0.147	0.049	104	137	138

Source: UNCTAD and Goldstein (2000)

Both measures again indicate Namibia's performance as an up-and-coming FDI destination in the SADC region. Finally we attempt to provide an indication in terms of the aggregate distribution of FDI flows and stocks by sectors in this section. Data limitations make this almost impossible and hence the figures provided here should be taken as indicative.

Table 10. Sectoral distribution of FDI in selected SADC Countries (percent of total)

Sector	South Africa	Mauritius	Botswana	Zimbabwe	Tanzania	Mozam-bique	Namibia
Agribusiness	0	0	0	15	7	9	3
Mining	28	0	79	12	39	19	28
Manufacturing	26	10	3	25	22	51	7
Utilities/ Transport	3	50	1	7	5	5	-
Construction	0	0	0	4	6	2	1
Trade/Services	4	5	10	37	13	6	2
Finance	39	17	6	0	8	7	46
Other	0	18	0	0	0	0	12

Source: Goldstein (2004) and author's compilation

The dominance of mining and financial services in Namibia is instructive. It is noteworthy that in countries like Mauritius, South Africa, Zimbabwe and Mozambique, FDI has been concentrated in manufacturing, trade/services and utilities /transport. South Africa remains the largest investor in the Namibian economy followed by other countries like Germany, and the UK. Among other OECD investors are countries like Sweden, the Netherlands and Switzerland. In recent times, the South East Asian countries such as Singapore and Malaysia have shown some remarkable interest in the Namibian economy.

4. Does FDI complement or substitute Domestic Investment in Developing Countries (with emphasis on Namibia)?

Two sets of evidence are attempted in this section. First, we examine some basic correlations and make tentative inferences on Namibia. Second, we do a rather eclectic review of evidence on spillovers in a larger sample of developing countries. A note of caution should be sounded here about forming broad conclusions from this evidence because of the unreliability of data used in this study.

From the review carried out in section 2, conceptually, we expect FDI to impact on domestic investment through its potential to crowd-in domestic investment. Thus the basic hypothesis tested in this section is whether FDI has crowded in or out domestic investment in developing countries.

These effects may have a dynamic dimension. There may be two rounds of effect of foreign affiliate entry into domestic industry (Kumar and Pradhan, 2003). Since they possess superior asset bundles, domestic entities may be affected adversely by the entry of foreign affiliates. They may witness a decline in their market share. The subsequent round effect may be more favourable with domestic rivals absorbing spillovers of knowledge as well as diffusion of knowledge through vertical linkages with domestic enterprises. Given the dynamic nature of the effect of FDI on domestic investment, analysis in a comparative static frame work may yield biased results.

4.1 FDI and Domestic Investment in Namibia

The nature of FDI and domestic investment is first examined in the framework of a simple model in which the current values of domestic investment are made a function of current and past values of FDI in addition to lagged values of itself (dependent variable) and lagged growth variable. Thus, our frame work is of the nature:

$I_{dt} = a_0 + a_1 I_{dt-1} + a_2 Id_{t-2}, + a_3 I_{ft} + a_4 I_{ft-1} + a_4 I_{ft-2} + a_5 g_{yt-1} + e_t$ ………… (1)

where *Id* and *If* are the domestic investment and FDI, both expressed as a ratio of GDP of the host economy, and *gyt-1* is the lagged growth rate, et is the classical disturbance term. The inclusion of present and lagged values of FDI in the model enables us to capture the possible dynamic nature of effect of FDI on domestic investment.

Data Sources and Variable Measurements

The data on GDP growth (annual percent), Gross Fixed Capital Formation (percent of GDP) and net FDI inflows (percent of GDP) was Sourced from the National Planning Commission, Central Bureau of Statistics, and Bank of Namibia, Annual reports (various issues) and UNCTAD, World Investment Report (various years)

The measurements of the variables used in the study:

gyt is the growth rate of GDP (annual percent).

Idt is the domestic investment rate. It is obtained as the difference between the total

investment rate and FDI ratio of the host economy.

Ift is the FDI ratio. It is defined as the net FDI inflows as a ratio of GDP. The period covered is from 1985-2004.

Dynamic Estimation Results

The inclusion of lagged dependent variables in the specification makes our estimation a dynamic model. For such models, the conventional estimation techniques namely OLS may be inappropriate.

The OLS estimates are biased and inconsistent as the lagged dependent variable is correlated with the error term violating a fundamental assumption. Anderson and Hsiao (1982) suggested an instrumental variable (IV) method for estimation of such dynamic models. In this study, we have reported the results of our OLS and IV estimations below. In addition, we have also reported the results of a simple error correction model. After estimating the long run relationship between id (dependent variable) and one and two period lags where appropriate of *id, if* and *gy* as independent variables, the residuals is tested for cointegration using the ADF test and its lag is incorporated into the short-run model as the error correction term.

Independent variables	OLS estimation	IV	Short-run ECM model Dependent variable (∆idt)
Id_{t-1}	0.2101	0.2824	
	(0.7543)	(1.854**)	
Id_{t-2}	0.6819		
	(2.6851**)		
If_t	-1.5182		
	(-4.5079*)		
If_{t-1}	0.8324		
	(1.6927***)		
If_{t-2}	0.0672		
	(0.1336***)		
gy_t	0.0211		
	(0.2915)		
Δgy_t		0.008	0.0463
		(11.2278)	(1.517***)
Δid_{t-1}			0.4833
			(1.1620)
Δid_{t-2}			0.6145
			(1.9518**)
Δif_t			-1.3313
			(-4.508*)
Δif_{t-1}		1.3028	1.1359
		(4.5455**)	(1.933**)
Ecm			-1.592
			(-3.3693*)
Constant			0.000022
			(0.0372)
R^2	0.60		0.85
Schwartz Criterion			-4.094
DW stat.	1.97		1.83
F-value	3.919		9.4855

Table 11. Estimations of the Effect of FDI on Domestic Investment in Namibia

Caution must be exercised in interpreting these results because of the short period of our estimation. With barely 18 observations, the results of the model should be taken in conjunction with other evidence advanced in this study.

Our results for all estimations suggest that FDI inflows in the current period and in the past years have a significant effect on domestic investment in the current year besides lagged domestic investment and the growth rate. However, the signs of the effect of FDI inflows in current period and the past years are different. Broadly, FDI in current period has a strong negative effect on domestic investment in the current period while the lagged inflows have positive effect. Real GDP exerts a positive impact on domestic investment although the coefficient is insignificant in all cases.

Domestic investment in the past years has significant positive effects on current domestic investment. The performance of the short-run ECM model is instructive for such a simple model. The ECM variable came out with the right sign and is significant, again emphasising the significant feedback from previous level investment to current domestic investment.

FDI and Investment: Causality Test

To further understand the relationship between FDI and investment, and to resolve the possible causality bias between them, we have used Granger Causality test in a bivariate VAR framework for Namibia. FDI would be considered 'Granger-causing investment' (dngc) only if the lagged values of FDI significantly contribute to the explanation of current investment. Therefore, this test essentially looks at the predictive performance between variables to determine the existence or direction of causality between them. Given the fact that it takes into account the effect of lagged values of the causing variable on the current value of the dependent variable, it takes care of the dynamic nature of FDI's effect on investment that we have postulated. The findings are summarized in Table 12 below.

Table 12. Granger causality between FDI and Domestic investment

	Null Hypothesis	Observations	No of lags	F-statistic	Probability	Conclusion
1	FDI dngc growth	19	4	0.2245	0.8017	Growth –>FDI
	Growth dngc FDI					
	FDI dngc domestic investment	17	4	3.3851	0.0310	
2	Domestic investment dngc FDI	17	4	4.4937	0.0167	FDI –> Domestic Inv
	Domestic investment dngc growth	17	4	2.4241	0.1247	
3	Domestic investment dngc growth	17	4	0.0867	0.9167	Granger neutral
	Growth dngc domestic investment	17	4	1.0263	0.4494	

The causality test between FDI and investment suggests existence of causality. Our result suggests unidirectional causality from FDI to domestic investment in Namibia. Growth rate is found to attract FDI in Namibia although the reverse is not established. Perhaps more interesting is the non-existence of a causality between domestic investment and any of the variants of growth (per capital real income, real growth rates, and nominal GDP growth rate) in our model.

4.2 FDI and Domestic Investment-Further Evidence from other developing countries[4]

In this sub-section we provide a summary of a similar study by Kumar and Pradham (2002) using the Arellano and Bond (1991) one-step and two-step generalized method of moments (GMM) framework. This approach utilizes the orthogonality conditions that exist between the lagged values of dependent variable and the disturbances. The method takes the first-difference of the model to eliminate the individual effects and then estimates it by using two or higher period lagged dependent variables as instruments following Hansen's optimal GMM framework.

The estimations for the panel of 98 countries including 38 African countries indicate that on the whole crowding-out dominates the effect of FDI on domestic investment. The results of the study show that there are significant inter-country differences which the author attributes to the ability to attract FDI of better 'quality' viz. those that generate more favourable externalities for domestic investment. This result was confirmed by his estimation of the model in equation 1 for each of the 83 countries in his sample that had at least 17 observations. In 52 of the countries, FDI had a significant coefficient. Of the 52 countries that have significant coefficient of FDI in Appendix 1, 29 countries experience net crowding-out effect from FDI and 23 experiences a net crowding-in. Of the 23 countries that have a net crowding in effect, 8 are from Africa.

Kumar and Pradharn went ahead to cross-tabulate the countries according to their regions and the nature of the effect. This we have reproduced in Appendix 2. Apparently crowding-out seems to dominate the relationship between FDI and domestic investment in the Latin America and Caribbean region with 17 countries in this group and only 7 reporting a crowding-in. In Asia and Africa the patterns of crowding-in and crowding out are more evenly distributed. This regional pattern has been confirmed by other studies (Fry, 1992; Agosin and Meyer, 2000).

5. Policy Implications

What are the policy lessons from the above analysis for Namibia? Namibia has performed very well in attracting FDI inflows especially since 1997. The indicators on FDI performance and potential performance show that both the country policies and environment make Namibia a very suitable destination for FDI.

[4] We have decided to report this study fully because it is one of the most recent studies and is quite comprehensive in its coverage on Africa.

Namibia's performance index has risen progressively especially since 1998. More interesting is the potential performance index which places Namibia above many countries in Africa including South Africa (see appendix 4). The matrix of inward FDI performance and potential (2001-2003) compiled by UNCTAD shows that though Namibia is shown as having low FDI potential, it comes under the category of countries classified as high performers and is placed higher than countries grouped as below potential and underperformers. A cursory look at Appendix 4 will show that a majority of African countries are classified as Low FDI performers.

The production technological index though shows a slight decline between 1995 and 2001 also portrays Namibia as way ahead of many countries like Tanzania, Angola and Nigeria, countries that have appropriated a disproportionate size of total FDI inflows to Africa in recent years. (See appendix 5). These indicators point to the fact that Namibia could substantially benefit from FDI inflows if coupled with appropriate domestic polices.

Our review in section 4 confirms that FDI inflows and stocks as proportion of GFCF and GDP respectively are quite high in Namibia. This will tend to suggest that FDI contributes substantially to GFCF and GDP in Namibia. The analysis in section 5 also confirms that FDI crowds in domestic investment in Namibia, thus suggesting that Namibia could benefit significantly from well-targeted FDI promotion. However, despite the unambiguous relationship between FDI and domestic investment, the finding that causality runs from growth to FDI and not vice versa calls for concern

Table 13. FDI and GDP growth rate

1	2 1990-94	3 1995-99	4 2000-2004	percent change between col. 2 and 3	percent change between col. 3 and 4
GFCF/GDP	0.193	0.222	0.234	15.0	5.4
FDI/GDP	0.674	0.436	0.316	-35.3	-27.5
FDI/GFCF	0.1535	0.139	0.241	-8.9	73.4
RGDP growth rate	3.6	2.4	3.2		

Real GDP growth rate has been low in Namibia hovering around 3.0 percent since independence. As an indicator of domestic economic performance, this is not a good pointer to the robust story that is told by the good performance of FDI during the period. Although a number of factors could be held accountable for this, Table 13 above identifies contraction in domestic investment as a major culprit. From a high of 19.1 percent (1990-94), GFCF as a ratio of GDP rose to 23.4 percent (2000-2004) after hitting 22.2 percent during the period 1995-99. However, the percentage change between 1995-99 and 1990-94 was 15.0 whereas between 2000-04 and 1995-99 was about 5.4 percent. FDI as a percentage of GFCF rose from -8.9 percent to 73.4 percent during the same period. Though the share of FDI in total investment more than quadrupled, this has not been translated to domestic economic growth. It would appear as if what seems to be happening here is a substitution of FDI for domestic investment.

One of the expectations from FDI is that it should help to stimulate domestic investment and thus enhance growth. This expectation may not have been fully realised in the Namibian situation. And because of the nature of FDI, it can hardly be expected to kick start domestic economic growth. A survey by UNCTAD (UNCTAD, 2005) showed that repatriated profits by FDI as percentage of FDI inflows in many developing countries constituted more than 50 percent (See Appendix 6). Thus, unlike domestic firms are wont to do, MNEs do not actively plough back profits into the domestic economy. What this calls for is that alternative strategies for getting the growth process started should be explored rather than waiting for MNE investment to stimulate the process of industrialization and development. Thus, the country will do better by focusing on improving infrastructure, human resources, developing local entrepreneurship, creating a stable macroeconomic framework and conditions conducive for productive investments to kick-start the process of development. Once the pace of development picks up, by harnessing and deploying domestic resources towards this end, FDI will probably flow in by itself and help in carrying the process forward. The point being made here is that FDI should not be looked up to as an instrument for kick-starting the growth process. Domestic economic resources should be mobilized to get growth growing.

Secondly, the effect of FDI on domestic investments and growth depend very much on the nature or quality of FDI. Certain types of FDI tend to have more favourable developmental spillovers than others. In that context attention needs to be paid by Namibia to the quality of FDI inflows besides attracting greater magnitudes of FDI. The preponderance of research on FDI over the past couple of years have shown that FDI that create backward linkages by expanding and deepening the skills of local suppliers as well as integrating them into global markets can stimulate domestic investment and thus promote economic growth.

A look at the structure of Namibia's FDI over the past couple of years (table 14) shows that the concentration of FDI is not likely to be growth enhancing. With a greater proportion of FDI in mining and financial services, the promotion of backward linkages with its attendant impact on employment and income is likely to have been compromised. The problem with the lop-sided distribution of FDI is that it may only not contribute to growth but it is also not pro-poor. By far the greatest complaint against mining is its inability to generate employment. Though a net foreign exchange earner, the labour force is often highly skilled and specialised. The poor do not participate in the economic opportunities of mining but bear the costs and the risks when a mine is situated in the community.

Table 14. Distribution of FDI in Namibia

	1996	1997	1998	1999	2000	2001	2002	2003
Agriculture	4.3	3.8	3.7	3.9	6.2	4.1	2.6	2.7
Mining	63.0	67.0	54.0	47.1	37.8	46.7	29.1	26.4
Manufacturing	6.4	4.5	6.5	8.4	8.1	8.4	4.5	4.8
Electricity/utilities	-	-	-	-	-	-	-	
Construction	0.5	0.4	0.2	0.3	0.3	0.3	0.1	0.0
Wholesale and retail trade	11.8	14.3	13.8	29.1	30.2	29.3	17.3	18.1
Transport	1.1	0.8	0.6	0.8	1.4	2.6	0.9	1.3
Financing	12.2	8.9	21.0	10.2	15.5	8.4	45.5	46.5
Community	0.1	0.1	0.0	0.01	0.01	0.0	0.0	0.0
Others	0.1	0.2	0.2	0.1	0.1	0.1	0.1	0.1

Source: Author's computation based on data from Bank of Namibia

The fear has been expressed that FDI in services and financial sectors may tend to displace local firms and local investors. Wholesale and retail trade, which also consumes a chunk of FDI, does not by itself create backward linkages. On the other hand, manufacturing has shown a lack-luster performance. Although the small size of the market could be a major constraint for manufacturing, recent studies have shown that this ought not to be. The main traditional drives of FDI such as large markets, the possession of natural resources and access to low cost skilled or unskilled labour, though still very important, are yielding ground to such factors as policy liberalisation, technical progress and evolving corporate strategies (UNCTAD, 2001).

Manufacturing can and do generate backward linkages. It has been found that within manufacturing, food products, beverages and tobacco, textiles and leather products have the capacity to generate backward linkages. It is noteworthy that the

Namibia Investment Centre is currently shifting emphasis to these sectors(sectors (NIC, 2005). There has been quite a lot of debate surrounding manufacturing exports and their ability to generate growth. Local linkages tend to be weak in export-oriented manufacturing because of the demands by foreign consumers for industry best practices and zero defect procedures and production audits[5]. Thus, greater productivity benefits tend to be associated with domestic market rather than foreign markets.

The question that naturally arises is “How can Namibia with its small market key into this process”? The answer lies in a more determined role in regional integration and more importantly, domestic economic policies that support more competitive domestic firms. Overall, countries that have made a huge success of using FDI to promote growth are those that have succeeded at raising their manufacturing component to between 40-60 percent. This naturally leads us to the issue of investment promotion.

Thirdly, recent work has shown that host country policies have an important bearing on the quality of FDI inflows received (see Kumar 2002, among others). Investment promotion policies have passed through different stages over the years. In the first generation, many countries adopted market friendly approaches by liberalising their FDI regimes – reduced barriers to FDI inflow, strengthened standards of treatment for foreign investors and gave greater latitude to market forces in resource allocation. During the second regime, Governments went further to actively seek FDI by “marketing” their countries. This was the era of national investment promotion agencies. Many countries now know that the issue is not how much of marketing you do about your country, but rather the quality of the basic economic factors available. The third generation of investment policies concentrated on proactively creating locational advantages by creating investment clusters for MNEs. A critical element of such investment promotion is to improve and market particular locations to potential investors in specific activities. This was the era of EPZs.

Recently it has been realised that it is not so much the mix of any of these three policies that promotes growth through FDI but rather the competitiveness of the domestic enterprise sector and the pool of skilled people that a country possesses. According to UNCTAD, 2001, “strong local firms attract FDI; the entry of foreign

5 This has been the case recently with Ramatex and AGOA.

affiliates, in turn feeds into the competitiveness and dynamism of channel for diffusing skills," Thus, the strongest channel for diffusing skills, knowledge and technology from foreign affiliates is the linkages they strike with local firms and institutions. This has also created a new strategy for investment promoters. Investment promotion agencies now specifically go out in pursuance of FDIs that could create backward linkages because of their potential to create employment by stimulating domestic suppliers. Many Governments have imposed performance regulations like local content requirements on MNEs to intensify generation of local linkages or export obligations for 'triggering a burst of export-focused investments' (see Moran 1998, Kumar 2001, for examples). Some have employed incentives such as pioneer industry programmes to attract FDI in industries that have the potential to generate more favourable externalities for domestic investment (see UNCTAD 2001, for examples).

In many countries like Singapore, Taiwan, Korea and Ireland, Governments have employed proactive measures that encourage foreign and local firms to deepen their local content. UNCTAD (2001) highlights some of the policy measures employed by different Governments in promoting linkages.

In redesigning its FDI policy, the Government may want to be quite specific on what it wants FDI to achieve. If the goal of FDI is to attract FDI so as to introduce advanced technology, improve management and expand markets, a direct indication of Government's success will be the number of domestic firms that have come into play to compete with foreign enterprises. Preferential treatment is no longer the norm. In a recent survey by the World Economic Forum in 2001, 1200 companies in 76 countries were asked to rank the most important factors for their investment decisions. Surprisingly, firms tend to locate in open competitive markets. Most foreign investors nowadays prefer to invest in an environment where there is free entry more market access and sound market infrastructure. Some of the features of such a market include: an ability to repatriate capital and remit profits, predictability and reliability of Government policies, access to local markets, ability to enforce contracts, size of the local market and adequate employment policies.

Fourthly, we cannot emphasize the role of backward linkages without mentioning the role of a pool of skilled people through whom such linkages can be effected. Knowledge spillovers whether horizontal or vertical require that people with the necessary pool of skill be available to copy or learn. UNCTAD compiles two indices that are of significance to us here. The performance of Namibia on these two indices is very instructive. The first is the Human Capital Index. This is calculated from the literacy rate (weight 1), secondary school enrolments (weight of 2) and tertiary enrolments in all subjects (weight of 3). Countries are classified into three broad categories-high, medium and low. Most African countries except South Africa, Algeria, Tunisia, Egypt and Botswana fall under the low category. What is instructive for Namibia is that her index of 0.337 reported in 1995 has further declined to 0.251 in 2001 (see Appendix 6). The second index is the technological activity index, which is a simple average of the normalised value of three variables: Research and Development manpower, patents in the US and scientific journal articles. Countries are again classified as High innovation, medium-high innovation, medium innovation, and low innovation. In 1995, Namibia was one of the very few African countries classified as medium innovation with an index of 0.185. However by 2001, the country had fallen to the low innovation group though she still retains the same index. What this points to is the need to strengthen policies that enhance domestic skills formation.

Finally, FDIs come into the domestic economy with enhanced superior competitive advantage. Earlier in this paper we argued that fostering domestic competitiveness will create environment for domestic firms to capture the benefits of FDI. However, foreign affiliates because of their superior positions may sometimes operate in an anti-competitive manner. This is what enables them to capture rent and make profits. What this calls for is the need to make domestic competition laws more effective in Namibia (Simana, 2005).

6. Concluding Remarks

In this paper we have attempted to analyze the relationships between FDI, growth and domestic investment in developing countries. A preponderance of our analysis is based on empirical evidence from works already done in this area over the past couple of years. We have argued that the effect of FDI on growth could be of a dynamic nature in that there may be two rounds of effect viz. a competition effect for domestic enterprises in the industry of the foreign entrant that is generally negative, and a subsequent round could include a usually favourable externality on domestic investment because of backward linkages. The net weight of these effects could depend on the nature of FDI projects or the quality of FDI which is known to vary greatly for different types of investments.

Given the fact that the nature of the relationship between FDI and domestic investment is at the heart of the former's effect on growth, we reviewed the effect of current and lagged values of FDI on domestic investment in current year. Overall, the effect of FDI on domestic investment is at best indeterminate. While for some countries, empirical results may tend to suggest that FDI crowds out domestic investment, there are a few countries where the opposite is the case. For Namibia, we found that FDI positively affects domestic investment. This finding needs to treated with caution given the various problems associated with the empirical analysis.

The tests of causality suggest that in a majority of cases the direction of causation is not pronounced in many developing countries. Again, our causality test for Namibia shows a unidirectional causality running from FDI to domestic investment. Like most other developing countries, the direction of causation seemed to be running from growth to FDI.

Thus in a substantial number of cases, growth rate of economy acts as a signaling mechanism for FDI. What this calls for is a more detailed examination of the factors that explain greater success of some countries in experiencing more favourable effects of FDI.

We have argued in this study that FDI that create backward linkages are likely to be more beneficial and better growth enhancing than other forms of FDI. Thus, in the case of Namibia, the quality of FDI, innovative investment promotion, and a pool of skilled workers are indispensable factors for the realisation of the potential benefits of FDI. Moreover, we argued for a conducive policy environment. The debate as to what constitutes “conducive policy” is unending. While a liberal trade and investment regime which allows MNEs full flexibility has been canvassed (see Moran for Mexico, 1998), Amsdem and Chu (2003) argue that the most important ingredient for capturing spillovers is a strong state acting to nurture domestic firms through effective, market friendly and performance-related subsidies. Each country must evaluate the options available within the given historical and structural context.

On some of these factors there is a broad-based agreement. A minimal level of education-skills that can absorb new knowledge, (Bronzestein, Gregario et al, 1998), country specific factors such as institutions and policies (de Mello, 1999) and the domestic economy’s overall absorptive capacity are some of the factors that shape a host economy’s ability to gain from efficiency spillovers.

Finally, we have suggested that countries should not hoist their developmental strategies on the benefits of FDI. Inward FDI should be seen as a valuable supplement to local domestic resource mobilisation efforts. A country that cannot raise funds locally or retain domestic savings should not count on FDI to form the fulcrum of its capital formation for the simple reason that such a country cannot guarantee foreign investors the existence of adequate returns or the safety of their investment. FDI should supplement and not replace domestic saving and investment.

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APPENDICES

Appendix 1 Countries with Significant coefficient of FDI in Investment Equation

Country	Sign of the coefficient of			
	FDI(t)	FDI (t-1)	FDI (t-2)	Net effect of FDI
Argentina	-1.581		2.059	Crowding in
Bangladesh	4.996			Crowding in
Barbados		5.374		Crowding in
Belize		-1.4231	1.1499	Crowding out
Bolivia			-1.644	Crowding out
Botswana	-1.059	0.64	-0.499	Crowding out
Brazil			-4.531	Crowding out
Burkina Faso		6.4846		Crowding in
Cameroon	-0.86	0.962	0.912	Crowding in
Chad**		1.575		Crowding in
Chile	-1.0538	0.8613		Crowding out
Columbia		1.455	-1.773	Crowding out
Costa Rica	-4.373		3.27	Crowding out
Cote d'Ivoire		0.961	-1.018	Crowding out
Cyprus		3.682		Crowding in
Dominica	-0.7966			Crowding out
Ecuador		-2.5371		Crowding out
El Salvador	-0.765	0.5392		Crowding out
Fiji	-0.826	0.319		Crowding out
Gambia	-0.6966	0.7869		Crowding in
Ghana	1.42	-1.109		Crowding out
Grenada	-1.121	1.073		Crowding out
Guyana	-0.929	0.916	-1.088	Crowding in
Haiti		8.0696		Crowding in
Honduras		3.0889		Crowding out
India**			-5.2697	Crowding in
Jamaica	-1.3717	1.5725		Crowding in
Korea, Rep. Of	-12.4973	17.3632		Crowding out
Lesotho	-0.8213			Crowding out
Mali	-1.6768			Crowding in
Mauritania		1.6476		Crowding in
Mauritius	3.567			Crowding out
Mexico	-1.635			Crowding out
Morocco			-2.153	Crowding in
Nepal	14.8534			Crowding out
Nigeria	-1.0687			Crowding out
Panama	-0.6461			
Papua New Guinea				Crowding out
Paraguay	-0.9432			Crowding out
Peru	-1.255			Crowding out
Philippines	-1.2983			Crowing out
Rwanda**	-1.5022			Crowding in
Senegal	4.539			Crowding in
Sierra Leone			0.75	Crowding in
Singapore	-0.959		1.072	Crowding out
Sri Lanka	-1.067		0.9511	Crowding in
St Kitts and Nevis			1.2265	
St Lucia**				Crowding out
Swaziland	-0.725	0.5047		Crowding out
Thailand	-0.725	0.656	-0.404	Crowding out
Uganda	-2.367			Crowding in
Uruguay	-2.6068	3.2418		Crowding out
	-1.9627	1.7744		Crowding in
	-1.9017	2.1955		

** Denotes cases where the estimated model is not significant even at 10 percent level. Blank cells indicate that estimated coefficient is not significantly different from zero in statistical terms.

Appendix 2 Summary Patterns of Relationships between FDI and Domestic Investments

	Asia	Africa	Latin America and the Caribbean
Crowding in	Bangladesh, Korea Rep. of, Nepal, Sri Lanka, Thailand	Burkina Faso, Cameroon, Chad, Gambia, Ghana, Mauritania, Mauritius, Rwanda, Senegal, Sierra Leone	Argentina, Barbados, Haiti, Honduras, Jamaica, Panama, Uruguay,
Crowding out	Fiji, India, Papua New Guinea, Philippines, Singapore	Botswana, Cote d'Ivoire, Lesotho, Mali, Morocco, Nigeria, Swaziland, Uganda	Belize, Bolivia, Brazil, Chile, Colombia, Costa Rica, Dominica, Ecuador, El Salvador Grenada, Guyana, Mexico, Paraguay, Peru,St Kitts and Nevis, St Lucia.
FDI coefficients not significantly different from zero	China, Indonesia, Malaysia, Pakistan, Turkey	Algeria, Benin, Burundi, CAR, DRC, Egypt, Ethiopia, Gabon, Guinea Bissau, Kenya, Madagascar, Malawi, Mozambique, Niger, Seychelles, Togo, Tunisia, Zambia, Zimbabwe	Dominican republic, Guatemala, St Vincent and the Grenadines, Trinidad and Tobago, Venezuela

Source: Kruman and Pradharn (2002)

Appendix 3 Causality between FDI and Economic growth

Unidirectional Causality	Unidirectional Causality	Feedback Causality	Granger neutral
FDI –> Growth	**Growth –> FDI**	**FDI –> <– Growth**	
Cameroon, Columbia, Guinea Bissau, Jamaica, Mexico, Paraguay, Senegal, St Lucia, Swaziland, Trinidad and Tobago, Uruguay, Zambia	Argentina, Belize, DRC, Ecuador, El Salvador, Guatemala, Guyana, Mauritania, Tunisia, Kenya.	Cote d'Ivoire, Indonesia, Malawi, Pakistan, Thailand	Bangladesh, Barbados, Benin, Burkina Faso, Burundi, CAR, Chad, Chile, China, Comoros, Costa Rica, Cyprus, Dominica, Dominican Republic, Egypt, Ethiopia, Fiji, Gabon, Gambia, Grenada, Ghana, Haiti, Honduras, India, South Korea, Lesotho, Madagascar, Malaysia, Mali, Mauritius, Morocco, Mozambique, Nepal, Niger, Nigeria, Panama, Peru, Philippines, Rwanda, Seychelles, Sierra Leone, Singapore, Solomon Islands, Sri Lanka, St Kitts and Nevis, St. Vincent and the Grenadines, turkey, Vanuatu, Venezuela, Zimbabwe

Source: Kumar and Pradharn (2002)

Appendix 4. Short-run error correction model

Dependent Variable: DDOMINV
Method: Least Squares
Date: 09/30/06 Time: 15:17
Sample (adjusted): 1988 2004
Included observations: after adjustments

Variable	Coefficient	Std. Error	t-Statistic	Prob.
DDOMINV(-1)	0.483336	0.415933	1.162054	0.2722
DDOMINV(-2)	0.614555	0.314855	1.951867	0.0795
DFDIFGDP	-1.331374	0.295294	-4.508647	0.0011
DFDIFGDP_1	1.135927	0.587522	1.933422	0.0820
LRESID	-1.592032	0.472510	-3.369307	0.0071
DGDPR	0.046322	0.030525	1.517506	0.1601
C	0.000225	0.006033	0.037273	0.9710

R-squared	0.850553	Mean dependent var	-0.001290
Adjusted R-squared	0.760885	S.D. dependent var	0.046485
S.E. of regression	0.022731	Akaike info criterion	-4.437265
Sum squared resid	0.005167	Schwarz criterion	-4.094177
Log likelihood	44.71675	F-statistic	9.485545
Durbin-Watson stat	1.830394	Prob(F-statistic)	0.001201

Appendix 5. Matrix of inward FDI performance and potential 2001-2003

	High FDI performance Front-runners	**Low FDI performance** Below-potential
High FDI potential	Bahamas, Bahrain, Belgium and Luxembourg, Botswana, Brazil, Brunei Darussalam, Bulgaria, Chile, China, Costa Rica, Croatia, Cyprus, Czech Republic, Denmark, Dominican Republic, Estonia, Finland, France, Hong Kong (China), Hungary, Ireland, Israel Kazakhstan, Latvia, Lithuania, Mexico, Netherlands, Panama, Portugal, Qatar, Singapore, Slovakia, Slovenia, Spain, Sweden, Switzerland, Trinidad and Tobago, Tunisia and Viet Nam.	Argentina, Australia, Austria, Belarus, Canada, Germany, Greece, Iceland, Iran, Islamic Rep., Italy, Japan, Jordan Kuwait, Lebanon, Libyan Arab Jamahiriya, Malaysia, Malta, New Zealand, Norway, Oman,Philippines, Republic of Korea, Poland, Russian Federation, Saudi Arabia, Taiwan Province of China Thailand, Ukraine, United Arab Emirates, United Kingdom and the United States
	Above - potential	**Under-performers**
Low FDI potential	Albania, Angola, Armenia, Azerbaijan, Bolivia, Colombia, Congo (Republic), Ecuador, Ethiopia, Gambia, Georgia, Guyana, Honduras, Jamaica, Mali, Mongolia, Morocco, Mozambique, Namibia, Nicaragua, Nigeria, Peru, Republic of Moldova, Romania, Sudan, Syrian Arab Republic, TFYR Macedonia, Togo, Uganda, United Republic of Tanzania and Zambia.	Algeria, Bangladesh, Benin, Burkina Faso, Cameroon, Congo, (Democratic Republic), Côte d'Ivoire, Egypt, El Salvador, Gabon, Ghana, Guatemala, Guinea, Haiti, India, Indonesia, Kenya, Kyrgyzstan, Madagascar, Malawi, Myanmar, Nepal, Niger, Pakistan, Papua New Guinea, Paraguay, Rwanda, Senegal, Sierra, Leone, South Africa, Sri Lanka, Suriname, Tajikistan, Turkey, Uruguay, Uzbekistan, Venezuela, Yemen and Zimbabwe

Source: UNCTAD

Appendix 6. Technology Activity Index

	Rank	1995		2001	
High innovation	1	Sweden	0.981	Sweden	0.976
	2	United States	0.963	Finland	0.973
	3	Japan	0.949	Switzerland	0.955
	4	Switzerland	0.947	United States	0.948
	5	Finland	0.932	Japan	0.935
	6	Denmark	0.931	Denmark	0.917
	7	Canada	0.930	Taiwan Province of China	0.902
	8	Norway	0.905	Canada	0.900
	9	Australia	0.900	Iceland	0.895
	10	Taiwan Province of China	0.890	Germany	0.891
	11	Germany	0.887	Norway	0.890
	12	United Kingdom	0.877	Singapore	0.875
	13	Netherlands	0.875	Netherlands	0.872
	14	France	0.867	Australia	0.870
	15	Israel	0.858	Belgium	0.863
	16	Belgium	0.848	United Kingdom	0.861
	17	Iceland	0.843	France	0.849
	18	Singapore	0.803	Israel	0.846
	19	Austria	0.798	Austria	0.830
	20	New Zealand	0.793	Korea, Rep. of	0.812
	21	Russian Federation	0.792	New Zealand	0.802
	22	Ireland	0.783	Ireland	0.781
	23	Slovenia	0.766	Slovenia	0.764
	24	Korea, Rep of.	0.762	Russian Federation	0.759
	25	Italy	0.753	Spain	0.744
	26	Estonia	0.734	Estonia	0.730
	27	Spain	0.728	Italy	0.703
	28	Belarus	0.721	Hungary	0.692
	29	Hungary	0.696	Greece	0.681
	30	Greece	0.660	Czech Rep.	0.680
Medium-high innovation	31	Ukraine	0.653	Portugal	0.678
	32	Georgia	0.643	Lithuania	0.674
	33	Poland	0.635	Hong Kong (China)	0.632
	34	Lithuania	0.629	South Africa	0.621
	35	Portugal	0.621	Belarus	0.618
	36	Bulgaria	0.619	Jordan	0.606
	37	Hong Kong (China)	0.613	Argentina	0.603
	38	Armenia	0.611	Bulgaria	0.602
	39	Argentina	0.609	Ukraine	0.600
	40	Saudi Arabia	0.601	Poland	0.598
	41	Czech Rep.	0.597	Slovakia	0.588
	42	Cyprus	0.597	Georgia	0.567
	43	South Africa	0.588	Kuwait	0.564
	44	Kuwait	0.576	Latvia	0.563
	45	Chile	0.560	Cyprus	0.555
	46	Uruguay	0.558	Chile	0.544
	47	Costa Rica	0.551	Armenia	0.543
	48	Romania	0.539	Saudi Arabia	0.538
	49	Slovakia	0.504	Costa Rica	0.526
	50	Venezuela	0.499	Romania	0.522
	51	Uzbekistan	0.493	Lebanon	0.507
	52	Lebanon	0.483	Brazil	0.478
	53	Mexico	0.474	Uzbekistan	0.472
	54	Brazil	0.459	Mexico	0.461
	55	Mauritius	0.457	Malaysia	0.446
	56	Egypt	0.430	Venezuela	0.438
	57	Jamaica	0.419	Turkey	0.425
	58	Turkey	0.415	China	0.417
	59	Latvia	0.412	Kazakhstan	0.404

Appendix 6. Technology Activity Index (cont)

	Rank	1995		2001	
Medium innovation	60	Zimbabwe	0.405	Egypt	0.387
	61	Malaysia	0.401	Thailand	0.361
	62	Morocco	0.396	Kenya	0.358
	63	China	0.390	Iran, Islamic Rep. of	0.336
	64	Qatar	0.362	Morocco	0.332
	65	Moldova, Rep. of	0.342	Zimbabwe	0.327
	66	Bahrain	0.340	India	0.323
	67	Thailand	0.340	Kyrgyzstan	0.323
	68	Peru	0.332	Jamaica	0.315
	69	India	0.328	Bahrain	0.311
	70	Kazakhstan	0.320	Colombia	0.311
	71	Sri Lanka	0.304	Uruguay	0.298
	72	Honduras	0.296	Sri Lanka	0.298
	73	United Arab Emirates	0.294	United Arab Emirates	0.290
	74	Tajikistan	0.288	Peru	0.289
	75	Colombia	0.288	Tunisia	0.285
	76	Philippines	0.264	Syrian Arab Rep.	0.281
	77	Dominican Rep.	0.255	Algeria	0.278
	78	Jordan	0.253	Qatar	0.277
	79	Iran, Islamic Rep. of	0.242	Moldova, Rep. of	0.275
	80	Mongolia	0.238	Philippines	0.265
	81	Kyrgyzstan	0.237	Botswana	0.261
	82	Botswana	0.231	Mauritius	0.257
	83	Tunisia	0.225	Ecuador	0.235
	84	Kenya	0.210	Tajikistan	0.231
	85	Indonesia	0.203	Viet Nam	0.231
	86	Pakistan	0.199	Tanzania, United Rep. of	0.227
	87	Namibia	0.185	Mongolia	0.221
	88	El Salvador	0.181	El Salvador	0.204
Low innovation	89	Oman	0.178	Madagascar	0.195
	90	Viet Nam	0.162	Uganda	0.185
	91	Benin	0.159	Namibia	0.185
	92	Algeria	0.155	Oman	0.176
	93	Malawi	0.151	Indonesia	0.175
	94	Zambia	0.143	Pakistan	0.169
	95	Paraguay	0.127	Nigeria	0.161
	96	Senegal	0.126	Bolivia	0.155
	97	Ghana	0.126	Ghana	0.139
	98	Bolivia	0.122	Malawi	0.130
	99	Ecuador	0.116	Benin	0.122
	100	Cameroon	0.113	Senegal	0.120
	101	Nicaragua	0.111	Cameroon	0.102
	102	Syrian Arab Rep.	0.111	Zambia	0.101
	103	Guatemala	0.105	Côte d'Ivoire	0.097
	104	Tanzania, United Rep. of	0.105	Nicaragua	0.081
	105	Nigeria	0.104	Honduras	0.076
	106	Côte d'Ivoire	0.092	Paraguay	0.075
	107	Uganda	0.079	Bangladesh	0.063
	108	Djibouti	0.071	Ethiopia	0.059
	109	Bangladesh	0.069	Guatemala	0.055
	110	Ethiopia	0.063	Mozambique	0.042
	111	Mauritania	0.038	Mauritania	0.038
	112	Madagascar	0.033	Dominican Rep.	0.029
	113	Mozambique	0.021	Yemen	0.021
	114	Eritrea	0.017	Eritrea	0.017
	115	Yemen	0.013	Angola	0.013
	116	Haiti	0.008	Haiti	0.008
	117	Angola	0.000	Djibouti	0.000

Appendix 7: Human Capital Index

	High					Medium					Low			
	1995		2001			1995		2001			1995		2001	
1	Australia	0.989	Finland	0.982	41	Argentina	0.670	Uzbekistan	0.655	81	Indonesia	0.349	Iran Islamic Re. of	0.355
2	Belgium	0.975	Sweden	0.982	42	Slovakia	0.657	Kazakhstan	0.646	82	Syrian Arab Rep.	0.340	El Salvador	0.354
3	Canada	0.964	Australia	0.971	43	Moldova Rep. of	0.653	Bahrain	0.622	83	Paraguay	0.339	Paraguay	0.351
4	Finland	0.963	Norway	0.957	44	Philippines	0.641	Singapore	0.621	84	Namibia	0.337	Indonesia	0.347
5	New Zealand	0.956	New Zealand	0.955	45	Singapore	0.635	Georgia	0.619	85	Mauritius	0.324	Algeria	0.347
6	Norway	0.954	United Kingdom	0.951	46	Bahrain	0.629	Thailand	0.615	86	China	0.318	Sri Lanka	0.337
7	United Kingdom	0.951	Denmark	0.934	47	Tajikistan	0.620	Chile	0.609	87	Nicaragua	0.313	China	0.298
8	Netherlands	0.949	Belgium	0.924	48	Chile	0.601	Lebanon	0.602	88	Albania	0.308	Oman	0.288
9	Denmark	0.938	Canada	0.914	49	Lebanon	0.593	Romania	0.586	89	Zimbabwe	0.298	Nicraragua	0.277
10	France	0.936	United States	0.905	50	Qatar	0.580	Jordan	0.584	90	Botswana	0.297	Honduras	0.272
11	Sweden	0.933	Netherlands	0.904	51	Hong Kong (China)	0.573	Philippines	0.581	91	Oman	0.290	Namibia	0.251
12	United States	0.929	Spain	0.895	52	Romania	0.569	Brazil	0.579	92	Viet Nam	0.275	India	0.247
13	Austria	0.907	France	0.877	53	South Africa	0.569	Bolivia	0.578	93	Honduras	0.262	Yemen	0.239
14	Spain	0.900	Austria	0.875	54	Cyprus	0.564	Cyprus	0.577	94	Morocco	0.251	Zimbabwe	0.229
15	Germany	0.892	Poland	0.867	55	Peru	0.563	Egypt	0.562	95	India	0.247	Morocco	0.222
16	Korea Rep. of	0.879	Korea Rep. of	0.866	56	Costa Rica	0.558	Mongolia	0.562	96	Guatemala	0.224	Guatemala	0.215
17	Ireland	0.875	Iceland	0.857	57	Armenia	0.538	Peru	0.561	97	Nepal	0.173	Syrian Arab Rep.	0.212
18	Japan	0.863	Ireland	0.848	58	Venezuela	0.509	Moldova, Rep.of	0.550	98	Nigeria	0.169	Bangladesh	0.180
19	Iceland	0.826	Latvia	0.846	59	Kyrgyzstan	0.504	Qatar	0.528	99	Côte d'Ivoire	0.166	Nepal	0.170
20	Belarus	0.819	Slovenia	0.838	60	Thailand	0.485	Hong Kong (China)	0.514	100	Zambia	0.157	Cameroon	0.167
21	Estonia	0.815	Japan	0.835	61	Egypt	0.469	Armenia	0.509	101	Cameroon	0.152	Kenya	0.161
22	Taiwan		Taiwan											
	Prov China	0.813	Prov China	0.829	62	Dominican Rep.	0.459	Tajikistan	0.493	102	Bangladesh	0.148	Côte d'Ivoire	0.157
23	Italy	0.809	Estonia	0.820	63	Iran, Islamic Rep	0.456	Malaysia	0.488	103	Yemen	0.146	Nigeria	0.153
24	Greece	0.806	Russian Fed	0.817	64	Kuwait	0.454	Venezuela	0.482	104	Kenya	0.137	Ghana	0.148
25	Ukraine	0.804	Portugal	0.814	65	Colombia	0.447	Mexico	0.477	105	Ghana	0.136	Zambia	0.130
26	Russian Fed	0.802	Lithuania	0.811	66	Turkey	0.446	Colombia	0.476	106	Pakistan	0.122	Pakistan	0.104
27	Poland	0.800	Ukraine	0.810	67	Bolivia	0.443	Jamaica	0.475	107	Mauritania	0.103	Mauritania	0.098
28	Switzerland	0.794	Germany	0.810	68	Ecuador	0.442	South Africa	0.475	108	Haiti	0.102	Uganda	0.095
29	Portugal	0.787	Switzerland	0.799	69	Mexico	0.433	Tunisia	0.445	109	Madagascar	0.097	Eritrea	0.092
30	Slovenia	0.760	Greece	0.794	70	Jordan	0.426	Albania	0.435	110	Senegal	0.083	Benin	0.090
31	Israel	0.758	Italy	0.789	71	Mongolia	0.405	Costa Rica	0.419	111	Uganda	0.083	Haiti	0.083
32	Bulgaria	0.723	Belarus	0.776	72	United Arab Emi	0.399	Saudi Arabia	0.140	112	Benin	0.077	Senegal	0.081
33	Georgia	0.722	Argentina	0.767	73	Saudi Arabia	0.391	Dominican Rep.	0.413	113	Eritrea	0.077	Malawi	0.080
34	Kazakhstan	0.722	Israel	0.762	74	Malaysia	0.385	Ecuador	0.404	114	Malawi	0.066	Madagascar	0.071
35	Uzbekistan	0.717	Hungary	0.758	75	Brazil	0.383	Mauritius	0.389	115	Tanzania, Rep.	0.056	Tanzania,Rep.	0.063
36	Hungary	0.713	Bulgaria	0.729	76	Tunisia	0.379	Kuwait	0.383	116	Angola	0.044	Djibouti	0.055
37	Lithuania	0.701	Uruguay	0.715	77	El Salvador	0.371	Botswana	0.370	117	Djibouti	0.043	Ethiopia	0.044
38	Czech Rep.	0.700	Czech Rep.	0.701	78	Jamaica	0.369	United Arab Em	0.363	118	Ethiopia	0.028	Angola	0.025
39	Latvia	0.697	Kyrgyzstan	0.676	79	Sri Lanka	0.368	Viet Nam	0.358	119	Mozambique	0.015	Mozambique	0.019
40	Uruguay	0.675	Slovakia	0.664	80	Algeria	0.359	Turkey	0.355					

Source: UNCTAD

Note: The Human Capital Index is calculated from the literacy rate (weight of 1), secondary enrolments (weight of 2) and tertiary enrolments in all subjects (weight of 3)

Appendix 8. FDI Inflows, Green field FDI inflows, and Profit remittances in selected Countries (1995-2003) Million US dollars

Countries	FDI inflows	Greenfield Projects	Profit remittances	Profit remittances as percent of FDI inflows
Algeria	4871	4699	1895	38.9
Angola	10761	10742	7169	66.6
Botswana	943	826	5621	596.0
Cameroon	577	503	421	73.0
Congo, Rep	1623	1548	2773	170.8
Cote'd'Ivoire	2500	2260	2366	94.6
Egypt	6895	2103	866	12.5
Gabon	-822	-883	3432	417.5
Guinea	244	154	332	136.0
Kenya	411	68	361	87.8
Mali	807	655	817	101.2
Morocco	9626	4998	2449	25.4
Mozambique	1855	1719	96	5.2
Nigeria	10784	10738	12387	114.8
Senegal	712	532	541	75.9
Sudan	3868	2494	1164	30.1
Swaziland	540	149	622	115.2
Tanzania, Utd Rep.	2396	1815	50	2.1
Tunisia	4387	3437	3516	80.1
Zambia	1158	603	362	31.3
Zimbabwe	910	867	837	92.0

Measuring The Benefits And Costs Of Foreign Direct Investment In Namibia

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We [the United Nations General Assembly] resolve to halve, by the year 2015, the proportion of the world's people whose income is less than one dollar a day. We also resolve to take special measures to address the challenges of poverty eradication and sustainable development in Africa, including debt cancellation, improved market access, enhanced Official Development Assistance and **increased flows of Foreign Direct Investment, as well as transfers of technology.**

(United Nations Millennium Declaration, 8 September, 2000)

Introduction

Foreign Direct Investment (FDI) is an important Source of private capital for developing countries. The UN conference on Finance and Development (FfD) argues that 'private international capital flows, particularly foreign direct investment, along with international financial stability, are vital complements to national and international development efforts'. Other international policy documents (e.g. the Cotonou Partnership Agreement, NEPAD, and the United Nations Millennium Declaration) also emphasize the importance of private sector investment—both domestic and foreign—in development and poverty reduction initiatives. Private sector investment—driven by FDI flows and domestic resources—also features prominently in the UK White Paper—Making Globalization Work for the Poor (DFID, 2000). In this light, developing countries have in general been recipients of both official and private financial flows over the last four decades. Understandably so; in many of these countries, the level of domestic savings is generally very low, the financial sector is widely underdeveloped and in most cases repressed, and the capacity to harness domestic financial resources for the development of key sectors of the economy is quite limited.

A wide body of literature has investigated the role that flows of external financing could play in the development of recipient countries; but as with most economic arguments, issues of the impact of FDI on host economies remain highly controversial and contentious. Some economists argue that if and when such flow is accompanied by conducive policy environment, FDI can accelerate host countries' growth. This is made possible by contributing to domestic Sources of capital, transferring and developing technology and expertise [Barrel and Pain 1997; Young and Lan, 1997; Lall, 2001], generating employment [Campbell, 1994; Lall, 1995; Zhao, 1998; Burnside and Dollar 2000] and exports [Collis et al., 1994; Aitken et al., 1997; UNCTAD, 2002], increasing competitive pressure in domestic markets, and creating externalities or spillovers (Dunning, 1996). Other researchers that have sought to examine the relationship between FDI and economic growth include Doraisami and Leng, 1996; Dunning and Narula, 1996; Borensztein et al., 1998; Sun and Chai, 1998; Liu et al., 2002; Ram and Zhang, 2002.[6]

On the other hand, some economists [Zukowska-Gagelmann, 2000; Driffield and Taylor, 2000; Nachum, 1999; Figlio and Blonigen, 2000; Glass and Saggi, 1999; Aitken and Harrison, 1999; Gorg and Greeaway, 2004, Caves, 1996]; argue that in some observed cases, FDI tend to have negative impact on the performance of some productive local firms, may lead to increase in wage inequality, weakens the link between location advantages and ownership advantages, negatively affects the productivity of domestic firms and may even have a crowding-out effect on local entrepreneurship. Furthermore, there remain some economists who have assumed neutrality in terns of the impact of FDI on host economies, [Fung et al., 1999; De Mello, 1999].

Whatever strand of the literature one tends to lean towards, what appears germane is that FDI inflow is associated with some costs and benefits for the host country; consequently, policy makers will need to carefully assess the impact of FDI if it is to become a complementary component of a wider package of development measures needed to raise growth, create jobs and diversify the economy into more dynamic activities. For African countries in particular, such evaluation will need to take into account the structural biases in the respective economies, including longstanding primary commodity exports dilemma as well as a deindustrialization trend following the debt crisis of the early 1980s (Wohlmuth et al., 2006; UNCTAD, 2005).

6 For a detailed survey of the literature on FDI and Economic Development, see Lall, 1996; Moosa, 2002.

The objective of this paper is not to contribute towards resolving the conflict in the literature as regards the impact of FDI on growth and development. We have rather attempted to examine what the observed situation has been in Namibia in terms of the net benefits and costs (if any) of FDI inflow in the last one and half decades. We may have to admit from the onset moreover, that this is a rather difficult task since in most cases, benefits and/or costs may not only be unobservable; data to conduct such analysis for developing countries are also rather difficult to come by. That accepted as a caveat; the remainder of this paper is organized as follows. In section 2 we examine (albeit very briefly), recent trend in FDI flows to Southern Africa and Namibia. Section 3 contains a review of existing theoretical, empirical and other related arguments in the FDI-impact-evaluation literature. The various Governmental interventionist policies in Namibia; aimed at repositioning the economy to attain a receptive and investor-friendly environment are highlighted in section 4. In section 5, we examine what the observed situation has been in Namibia in terms of FDI inflow and impacts thereof; a macro approach as well as a rather simplistic cost-benefit analysis technique was adopted in this regard. Summary and conclusions, and what lies ahead for Namibia are given in section 6.

2. FDI In Southern Africa And Namibia – A Brief Overview

In Table 1, we show the rates of aggregate (gross domestic) investment, gross domestic savings, foreign direct Investment (FDI), foreign aid and economic growth for each SADC country during the 1990s. From received theory, the difference between gross domestic investment and gross domestic savings constitute what is termed the resource gap. In general, developing countries can fund bridge this resource gap by attracting foreign capital inflows. The table shows that average savings ratios of less than 10 percent are recorded in half of the SADC members, while only four countries have savings rates in excess of 20 percent.

Table 1. Sources of Investment, Percent of GDP, Average for 1990-99

	Investment[1]	Domestic Savings	Foreign Capital			GDP Growth (percent)
			FDI	Aid	External debt[2]	
Angola	13.4	19.3	5.7	5.4	157.8	0.4
Botswana	26	33.7	0.3	2.4	13.3	4.3
DR. Congo	7	8.5	0.0	4.0	178.2	-5.1
Lesotho	57.2	-39.4	13.9	14.4	69.5	4.4
Malawi	17.3	3	1.3	26.1	114.9	3.8
Mauritius	28.3	24	0.8	1.2	44.4	5.1
Mozambique	19.8	-6.6	2.7	39.8	238.3	6.2
Namibia	21.7	9.3	3.3	5.7	12.9	3.4
Seychelles	31.5	22.3	6.8	4.3	35.2	3.3
South Africa	14.8	17.6	0.6	0.3	17.5	1.9
Swaziland	24.8	21.7	5.3	4.2	22.8	3.1
Tanzania	21.4	1.8	1.3	18.8	127.6	2.8
Zambia	14.1	7.1	3.5	24.5	201.3	0.2
Zimbabwe	19.7	16.9	1.3	5.9	60.3	2.8

Sources: World Development indicators 2001 CD ROM, World Bank; and Jenkins & Thomas, 2002.

Gross Capital Formation. 2. Stock of external debt to GDP

FDI and/or other long-term loans are the most sustainable method of absorbing foreign savings over a long period of time in order to bridge the resource gap. Most Southern African countries have been found to do this by absorbing foreign aid—loans at concessional rates of interest. As could be gleaned from Table 1, during most part of the 1990s, annual aid inflows was on average larger than FDI inflows for 10 of the 14 SADC members. This may then explain why these same countries have high external debt-to-GDP ratios (e.g., Malawi, Mozambique, Tanzania and Zambia). What this then seems to suggest is that; in comparison to aid flows, inflows of FDI are not significant source of investible resources for many SADC members. Those members that were able to attract larger than average inflow of FDI are countries with significant natural resources.

On another note, Table 2, which shows the trend in FDI inflow into the SADC region for the period 1990-2004, reveals not just the volatility in the flows over the years; it also shows that only Angola and South Africa attracted what could be termed significant inflows over the entire period. FDI inflows to Namibia which peaked at US$365 million in 2000—1.8 percent of total flows to Africa—declined to US$149 million in 2003. This figure rose to US$286 million in 2004 (or 1.6 percent of total flow to Africa). For SACU member countries and for Namibia in particular table 3 reveals that for the period 2000 to 2004, FDI inflow (though quite low in relative terms as shown in table 2); constituted significant proportion of total investment in the region (38.6 percent of GFCF for Namibia in 2004). The Namibia case may well be explained, not just by the presence of natural resources (minerals), but also the establishment of the EPZ scheme and other attractive domestic policies that made Namibia an investor-friendly country.

Moreover, given the relatively low importance of FDI in terms of funding the resource gap for many of the SADC countries, the conjecture could be made that it is unlikely that rates of economic growth and FDI will show any significant correlation, although FDI is just one of many factors, identified in the growth literature as being correlated with growth. One thing that is also clear from the table is that low levels of net FDI inflows during the 1990s are not necessarily associated with slow economic growth (for instance in Botswana and Mauritius); nor are relatively large inflows necessarily associated with rapid economic growth, as in Angola and Zambia. Domestic financial resources may therefore have played some significant roles in the growth prospects in some cases.

Table 2. Foreign Direct Investment Inflows into SADC; 1990-2005 (US$ Millions)

	1990	1995	1999	2000	2001	2002	2003	2004
Angola	-335	472	2471	879	2146	1672	3505	2048
Botswana	96	70	37	57	31	405	418	47
DR. Congo	-14	-22	11	23	82	117	158	900
Lesotho	16	23	33	31	28	27	42	52
Malawi	23	6	59	26	19	6	10	16
Mauritius	41	19	49	277	32	33	70	65
Mozambique	9	45	382	139	255	348	337	132
Namibia	30	153	20	186	365	181	149	286
Seychelles	20	40	60	56	65	48	58	60
South Africa	-78	1241	1502	888	6789	757	720	585
Swaziland	28	43	100	91	51	90	-61	69
Tanzania	0	150	542	282	467	430	527	470
Zambia	203	97	163	122	72	82	172	334
Zimbabwe	-12	118	59	23	4	26	30	60
As Percentage of total Inflows to Africa								
Angola	..	8.4	20.8	9.1	10.7	12.9	19.5	11.3
Botswana	3.4	1.3	0.3	0.6	0.2	3.1	2.3	0.3
DR. Congo	..	..	0.1	0.2	0.4	0.9	0.9	5
Lesotho	0.6	0.4	0.3	0.3	0.1	0.2	0.2	0.3
Malawi	0.8	0.1	0.5	0.3	0.1	0	0.1	0.1
Mauritius	1.4	0.3	0.4	2.9	0.2	0.3	0.4	0.4
Mozambique	0.3	0.8	3.2	1.4	1.3	2.7	1.9	0.7
Namibia	1.1	2.7	0.2	1.9	1.8	1.4	0.8	1.6
Seychelles	0.7	0.7	0.5	0.6	0.3	0.4	0.3	0.3
South Africa	..	22.2	12.6	9.2	33.9	5.8	4	3.2
Swaziland	1	0.8	0.8	0.9	0.3	0.7	..	0.4
Tanzania	0	2.7	4.6	2.9	2.3	3.3	2.9	2.6
Zambia	7.1	1.7	1.4	1.3	0.4	0.6	1	1.8
Zimbabwe	..	2.1	0.5	0.2	0	0.2	0.2	0.3

Source: Computed from UNCTAD (2005). Handbook of Statistics.

Table 3. Inward Foreign Direct Investment Flows as a Percentage of Gross Fixed Capital Formation (GFCF) (1990-2004)

	1990 – 95	2000	2001	2002	2003	2004
World	4.1	20.8	12.8	10.6	8.3	7.5
Developed Countries	3.6	22.9	12.7	10.9	7.9	6.1
Europe	5.4	41.6	24.0	22.9	16.1	8.6
Developing Countries	5.7	14.6	12.7	9.5	8.8	10.5
Africa	4.9	8.8	19.4	13.0	15.0	12.5
Latin America and the Caribbean	7.4	20.7	20.0	15.4	12.9	15.5
South East Europe and the CIS	4.8	17.9	14.6	11.6	17.1	19.1
Asia	5.2	13.1	9.8	7.7	7.3	9.1
Least Developed Countries	5.2	5.9	8.2	16.2	23.0	20.8
Southern Africa	..	..	..	7.7	4.2	2.7
Botswana	-2.4	4.2	2.2	33.1	23.7	2.3
Lesotho	44.4	8.2	8.7	8.8	9.6	14.6
Namibia	16.7	23.8	39.9	32.4	15.8	38.6
South Africa	1.3	4.7	40.5	4.5	2.7	1.7
Swaziland	26.6	10.4	34.0	42.7	-25.7	24.9

Source: Computed from UNCTAD (2005). Handbook of Statistics.

3. Assessing the Benefits and Costs of FDI to Host Countries – Issues of Relevance

3.1 The Form of FDI

The form in which FDI occurs may influence the extent to which the host country can benefit from the presence of foreign-owned firms. A significant proportion of worldwide FDI in the past decade, to developing countries and countries in transition, has been in the form of mergers and acquisitions, as opposed to greenfield investment; most probably explainable by the recent wave of globalization and structural reforms sweeping across many of these countries in recent times.

The World Investment Report 2000 (UNCTAD, Geneva) explores many of the concerns associated with the impact of acquisitions by foreign companies in developing countries. These include the view that acquisitions do not necessarily add to productive capacity (in contrast to Greenfield investment, where aggregate economic activity necessarily increases); the observation that a change in ownership frequently has an adverse impact on employment and production, which may actually decline as rationalization takes place in the case of acquisitions; the possibility of market dominance of strategic sectors by new foreign owners; and the possibility of reduced competition as domestic firms are eliminated. UNCTAD concludes that, in the short term, acquisitions may have fewer benefits (or larger costs) than Greenfield investment for the host country. Nevertheless, it is argued that what matters more for developmental impact in the longer term is the 'motivation' for foreign investment. For instance, not all acquisition is motivated by a desire to eliminate domestically-owned competitors in a particular market, and subsequent investment for expansion or modernization, with potential gains for output and employment, can happen regardless of the initial method of entry into an economy.

3.2 The Promise of FDI

The promise of FDI as an engine for economic development in developing countries has gained momentum over the last twenty years. In the 1970s, many developing countries were mistrustful of multinational corporations (MNCs), fearing a loss of sovereignty and preferring to borrow from banks to finance development projects. After the debt crisis of the 1980s, FDI became highly sought after, especially with the widespread embrace of export-oriented development strategies. Competition for FDI, among both developing and developed countries, is now very intense. To attract it, developing countries are being told to "get the policies right," that is, embrace macro-economic policies, especially the deregulation of financial markets, which promote global integration. Developing countries are also expected to fashion the right "enabling environment" for FDI—the legal, regulatory and political institutions which provide transparency, protection and stability to foreign (and domestic) investors; and social infrastructure, such as education, which increases the skills of the local workforce. Developing countries which have such an "enabling environment" ordinarily should be quite successful in attracting FDI, (though the now glutted literature on the determinants of FDI inflow in developing countries and observed trends of the inflows too have not seriously supported this argument). Most developing countries of Africa, especially the poorest, do not have this enabling environment anyhow.

The promise of FDI for sustainable development is precisely that it could be a useful tool in creating an enabling environment for sound economic and social development. The potential of FDI, in other words, is to help nurture local conditions and capacities—productive, social, regulatory and institutional.

3.3 Does FDI Promote Economic Development? Yes, No, Maybe

FDI can potentially bring two broad kinds of economic benefits to developing countries such as Namibia:

- Economic growth
  - increase in income;
  - increase in local employment;
  - increase in foreign exchange;
  - improvements in income distribution;
- Productive capacities
  - transfer of technology and management practices;
  - spillovers (stimulation of local suppliers and subcontractors);
  - externalities, including through agglomeration effects;
  - stimulation of domestic investment;
  - increases in productivity of domestic firms;
  - increased integration in global markets
  - decreased costs/increased rates of R&D and innovation.

FDI can also be associated with some costs in the host countries. In a study for the International Institute for Economics, Theodore Moran cautions that there exists the possibility that FDI could lead to fundamental economic distortion and pervasive damage to the development prospects of the host country. Such problems could arise from the possibility that FDI could lower, rather than raise domestic savings and investment, including via profit repatriation; crowd-out domestic companies from capital markets; increase demands for foreign exchange; support local oligopolies and be anticompetitive; distort local politics and thwart regulation; and create instability through increasing financial volatility. Furthermore, MNCs may seek to protect technology rents rather than transfer technology, reducing or eliminating the hoped-for spillovers and externalities.

What then is the more likely “face” of FDI? A host of studies over the past decade have examined the nature of economic benefits and the conditions under which they are—or are not—captured[7]. Many studies find that the impacts of FDI in

[7] Some of the literature in this regard have already been highlighted in section 1.

developing countries may be positive or negative, depending on a variety of variables, mostly having to do with host country policies. One study found that the impact of FDI is significantly positive in “open” economies, and significantly negative in “closed” economies. Others have found that positive impacts depend on the effectiveness of domestic industry policies; and on tax, financial or macroeconomic policies A World Bank study found that the impacts of FDI depend on the industry, as well as host country policies. (see Table 4).

Several studies suggest that, to capture the benefits of FDI, a country must already have reached some kind of “development threshold”. One found that FDI raises growth only in countries where the labor force has achieved a minimum level of education (Borensztein et al, 1998). In its recent report on the role of FDI in development, the OECD concluded that the overall benefits, while “well-documented”, depend on “the appropriate host-country policies and a basic level of development”, (OECD, 2002). What the “right policies” are, however, is a matter of some contention, as well as investigation. While it is slowly changing, the conventional wisdom is that developing countries should undertake policies which promote global integration, protect foreign investors, and minimize Government intervention in domestic economic activities.

3.4 FDI and Domestic Investment – the Complementarity and Crowding-out Issues

For a number of reasons, it is expected that FDI will have an impact on domestic investment level—positive or negative. In what follows, we highlight the different arguments in this regard.

(a) FDI is part of domestic investment. Hence any increase in FDI will by definition contribute to an increase in domestic investment. In addition, FDI and domestic investment are likely to be determined, to a large extent, by similar variables reflecting the investment climate of the country. An increase in FDI is therefore likely to be accompanied by an increase in domestic investment. This increase in investment should then result in a demand impulse with further multiplier and accelerator effects on national income and investment.

Table 4. Does FDI Promote Economic Growth?

Study Authors	Year	Yes, No, May be	Key Variables
Carkovic & Levin	2002	No	Doesn't generate spillovers
Lensink & Morrissey	2001	Yes	Reduces Costs of R&D and promotes innovation
Loungani & Razin	2001	Yes, but	Risks
Hanson	2001	No	Doesn't generate spillovers
Willem te Velde	2001	May be	Depends on industrial & macroeconomic policies
Lim	2001	May be	Depends on tax incentives, regulatory & legal impediments, macroeconomic instability
Marino	2000	Yes if…	Open trade and investment policies
Aitken & Harrison	1999	No	Reduces Productivity of domestic firms; doesn't generate spillovers
Mallampally & Sauvant	1999	May be	Human resource development; information and other infrastructure
Markussen & Venables	1999	Yes	Raises productivity and export of domestic firms; generates spillovers
Moran	1998	May be	Depends on policy variables controlled by host authorities
Borensztein et al.	1998	May be	Depends on education level of workforce
De Melo	1999	May be	Depends on open-economy performance and domestic policy
Blomstrom & Kokko	1999	May be	Impacts depend on industry and host country policies
Blomstrom & Kokko	1996	May be	Impacts depend on industry and host country policies
Graham	1995	Yes. but	MNCs market power can generate negative impacts

Source: Zarsky, L & Gallagher, K (2003). Searching for the Holy Grail? Making FDI Work for Sustainable Development. Paper prepared for a WWF-UK Workshop on International Investment Frameworks for Sustainable, London, March 10.

(b) New FDI projects—particularly Greenfield FDI—may invite complementary domestic investments that provide inputs to, or use outputs of, the foreign firm(s).

In this context, it may also be necessary to highlight that fact that two characteristics set FDI apart from most other types of capital flows to developing countries. The first is that FDI flows to the private sector of the host country and increases private investment and also the growth efficiency of investment (i.e. the incremental capital ratio may change). Other capital flows, such as aid or loans, are often received by the public sector (Government and state enterprises). It has been suggested that the impact of private investment on growth is stronger than that of public investment (Khan & Reinhart, 1990). The second aspect is that FDI generally consists of investments in the traded goods sector. Other capital flows, such as aid or loans to the public sector, tend to predominantly finance investments in the non-traded sectors of physical and social infrastructure. The assumption is often made that technical progress in traded activities is faster than that in non-traded activities (De Melo, 1998; Van Wijnbergen, 1986). Due to these two characteristics, FDI could exert a stronger impact on growth than other capital inflows from abroad.

(c) It is likely that domestic investment will increase by more than the FDI flows because foreign equity capital finances only part of total investment in a project. A substantial part of foreign investment projects is usually financed through the local financial market, particularly in such countries where a vibrant stock exchange exists and where other Sources of private equity capital are well developed. This is usually the case when the project is a joint venture, but even in cases of full foreign ownership, local financing may still be prevalent. Local financing provides the foreign investor with the opportunity to reduce the investment risk and to obtain cheap finance (particularly when local financial markets are repressed). Local financial institutions will see them as first-class borrowers; and in some cases, MNCs may have bargained for some credit facilities as part of the investment incentive package.

It has been argued in the literature that these interactions on the domestic financial markets may also lead to crowding-out of domestic investment (Bos et al., 1974; Lall & Streeten, 1977; Huges & Dorrance, 1987). The extent to which claims by foreign investors will crowd out local borrowers depends on the conditions of the financial markets. If the markets are tight—due for example, to large claims by the public sector to finance its deficit, or because of low deposit supply due to unattractive interest rates—crowding out is more likely. On the other hand, the presence of MNCs may ease the country's access to international financial markets, so that tension on domestic financial markets can be resolved by foreign borrowing. Furthermore, the foreign capital inflows can themselves lead to an increase in domestic credit supply. Inflows of foreign funds—FDI, PFI, or other capital inflows—may increase the level of foreign reserves, and thus the monetary base of the monetary system, and will thus initially increase the credit supply capacity.

(d) Crowding out may also occur on commodity and factor markets. This may be the case when foreign investors claim scarce resources (such as import licenses, skilled manpower, credit facilities, etc.) or when foreign investors foreclose investment opportunities for domestic investors.

From the foregoing, one may be able to say with some degree of confidence that FDI carries costs as well as benefits for the host country. Consequently, it is important that policy makers in the different countries––particularly of SSA—undertake an extensive evaluation of the impact of FDI if it is to serve a complementary component of a broad economic diversification, and sustainable industrial and economic development strategy. That is, if a growth that will unlock people's potentials and create jobs is to evolve in the country. This is an important issue that this paper tries to address.

4. The Namibian Experience[8]

Immediately after political independence in 1990, the Government of Namibia recognized the potential problems associated with over-dependence on proceeds from exhaustible resources and subsistence agriculture—the primary commodities dilemma—for sustained growth and development of the economy. Experience from other countries showed very clearly that there are difficulties associated with development that is hinged on a narrow commodity base. The limitations caused by small size of the domestic market were apparent and it was clear from the onset that mining and subsistence agriculture alone—whatever other benefits they promised— would not be sufficient as the major Sources of employment for the Namibian people. In this context, even as the mining sector gained momentum, the need for diversification of the economy was realized as an explicit policy objective. This objective was pursued at several distinct levels over the years.

Additionally, the Government of Namibia also recognized the fact that even though it can continue to play a pivotal role in influencing the pace of development of the country in general, the private sector needs to be brought on board and supported

8 This sub-section derives essentially from Esau Kaakunga and Gerson Kadhikwa (2006).

in the drive towards achieving a more diversified economy. To this end, the Government has put in place many policies and programmes and established some institutions aimed at attracting foreign investment, encouraging domestic investors, and promoting the development of the private sector. These initiatives include, inter alia, the Export Processing Zone, the Foreign Investment Act of 1990, the special incentives for manufacturing enterprises, the Namibian Stock Exchange, the Regulation 28 of the Pension Funds Act, and so on. The reminder of this section provides a brief discussion of some of these initiatives.

4.1 Government Support for Investment (Domestic and Foreign)

4.1.1 Export Processing Zone

An export processing zone (EPZ) is one of the many trade policy instruments used to promote non-traditional exports. It has adopted features from the much older industrial park and free trade area concepts and appeared in the late 1950s to early 1960s in different parts of the world, such as Taiwan, Singapore, Malaysia etc. The Namibian tax free EPZ regime effectively got off the ground in 1996, after the proclamation of the Export Processing Zones Act (Act No. 9 of 1995) in 1995 and its amendments in 1996 (Act No. 6, of 1996). Key objectives of the regime include (i) attract, promote or increase the manufacture of export goods; (ii) create or increase industrial employment (iii) create or expand export earnings; (iv) create or expand industrial investment, including foreign investment and (v) encourage technology transfer and the development of management and labour skills in Namibia. It has attracted significant local and international interest. It is regarded as a vehicle for export-led industrialization of the Namibian economy. The incentive package it provides is wide-ranging and very competitive. Since its inception, entrepreneurs from around the world have applied for participation in the regime. Some of the foreign Sources of investment into the Namibian EPZ regime are China, USA, Britain, Germany, India, Canada, and South Africa among others.

Companies granted EPZ status can set up operation anywhere in the country. In addition, there are specially developed industrial parks where they can enjoy the same advantages. These parks are at Walvis Bay, Oshikango and Katima Mulilo among others. The enterprises are also engaged in diverse economic activities such as manufacturing of acrylic products, manufacturing of automobile parts, rebuilding and reconditioning of motor vehicles, polished diamonds, electric and electronic components, zinc refinery, tannery, clothing, kitchenware, teddy bears, candles, copper processing and internet related services. There are no restrictions on industrial sector that can be participated in—any form of manufacturing or value-added process is deemed eligible, provided it is focused on exports outside the SACU region. However, sales to local markets of up to 30 percent of production can be allowed on request.

In addition, companies granted the EPZ status receives both tax and non-tax benefits. They do not pay: (a) corporate tax, (b) import duties on imported intermediate and capital goods; (c) value added tax, stamp and transfer duties on goods and services required for EPZ activities. Other incentives for EPZ enterprises include: permission to maintain foreign currency accounts in local banks; the labour amendment act makes provision for strikes and lock outs illegal in EPZ, but workers can join trade unions; enterprises investing in skills development and productivity enhancement of Namibian workers may receive a grant to cover a substantial part of the direct costs of on-the-job and institutional training. The grant is paid by the Government on the basis of pre-approved training plans, once training is completed. Through the Offshore Development Company (ODC), EPZ enterprises also have access to factory facilities rented at economic rates. An EPZ enterprise may choose to become either a stand-alone factory located anywhere in Namibia or an enterprise within an industrial estate managed by a management company. EPZ firms can be either private or public companies and can be foreign owned. Investors have the choice to deal through the umbrella organisation (the ODC) or the EPZ management company, thus avoiding the sometime cumbersome Government procedures.

4.1.2 Foreign Investment Act

In the attempt to attract foreign investment to Namibia, the Government drafted the foreign investment Act in 1990 which commenced on 7th July 1992 and amended by Act No. 24 of 1993. The foreign investment Act was meant to make provision for the promotion of foreign investments in the country. It provides liberal foreign investment conditions, including equal treatment of foreign and local investors, full protection of investments and openness of all sectors of the economy. However, in the case of the exploitation of natural resources, the Government may be entitled to an interest, or grant more favorable rights to Namibians.

The Act also provides for the granting of a certificate of status investment to foreign investors that fulfill certain criteria regarding the size and nature of their investment. Benefits that accrue to the holders of the certificate are (i) preferential access to foreign exchange to repay foreign debt, royalty or similar charges, remit branch profits and dividends as well as proceeds of sale of an enterprise; (ii) the right to retain foreign exchange earnings from exports abroad and (iii) exemptions from restrictions of the Act regarding categories of business reserved for Namibians.

4.1.3 Special Incentives for Manufacturing Enterprises[9]

The Government of the Republic of Namibia also introduced incentives for manufacturing enterprises in 1993. The incentives are in two forms: (i) tax incentives provided for under the Income Tax Act, No.24 of 1981 as amended by Acts No.10 of 1993, No.17 of 1994, and No.12 of 1996; (ii) tax and non-tax incentives apply equally to local and foreign companies registered as manufacturers and are provided to both existing and potential entrepreneurs operating in the manufacturing sector. The main objective of these set of incentives[10] is to give Namibian based entrepreneurs who invest in manufacturing and export a competitive advantage.

Namibian based entrepreneurs that operate under the incentives for registered manufacturers are entitled to payment of a reduced corporate tax rate of 18 percent for a maximum period of ten years, after which the corporate tax rate payable is restored to the normal corporate tax rate of 35 percent per year. Furthermore, businesses which are registered as manufacturers do not pay value added tax (VAT) when they purchase and import machinery and equipments. Furthermore, to encourage manufacturing concerns to erect premises, a special building allowance, whereby factory buildings are written off at 20 percent in the first year and the remaining balance at 8 percent for ten years is offered. This represents an accelerated depreciation method which allows faster write-offs than the straight line method[11].

The other incentives offered to registered manufacturers includes land-based transportation allowance which reduce the total transport cost of goods transported by rail or road by 25 percent as well as an export promotion allowance of 25 percent

9 Manufacturing is defined as: “the physical or chemical transformation of materials or components into new products, whether the work is performed by machine or by hand, whether it is done on or offsite, and whether the products are sold wholesale or retail”.

10 A company seeking the status of a registered manufacturer should contact the Namibia Investment Centre or the Industrial Development Directorate in the Ministry of Trade and Industry, which processes applications and make recommendations to the Ministry of Finance.

11 A method of calculating the depreciation of an asset which assumes the asset will lose an equal amount of value each year.

from taxable income. These incentives operate in the form of tax deductible expenses[12]. Another incentive which is claimed as a tax deductible expense is the incentive for training. Under this incentive, registered manufacturers are entitled to a deduction ranging between 25 percent and 75 percent of the taxable income as an incentive for training. This means that companies are not taxed on the expenditure that they incur as a result of providing training to their employees.

In addition to the above mentioned incentives, registered manufacturers also benefit from non-tax incentives such as:

a) the subsidization of industrial studies by 50 percent of their actual costs;

b) provision of cash grants which cover up to 50 percent of the direct cost of approved export promotion activities.

The general objective of the non-tax incentive is to provide financial assistance to exporters of Namibian manufactured products to enable them to carry out the following activities amongst others:

- engage in primary export market research;
- attend regional and international trade fairs and exhibitions and;
- engage in any other related activity.

In addition to the standard incentives for registered manufacturers, there are also incentives offered to businesses which export manufactured goods, except fish and meat products. The products can either be manufactured in Namibia or not. The exporters are provided with an 80 percent income tax allowance on the income derived from exporting such goods. For a company to benefit from this incentive it must be an exporter of manufactured goods or exporting must be one of the business lines of the enterprise; and the activities of the exporters have to be approved by the Ministry of Finance.

5. Foreign Direct Investment – The Benefits and Costs in Namibia

From the foregoing, the conjecture can be made that over the years, in its efforts at boosting the investment climate, the Government of Namibia had instituted a number of laudable programmes and policies. Namibia has actually been regarded

[12] An item or expense subtracted from adjusted gross income to reduce the amount of income subject to tax.

by the international community as one of the few African Countries that tried to put in place the required institutions, policy and regulatory frameworks, not just for attracting foreign direct investment (FDI), but for the development of the private sector. In this section of the paper, an effort is made to assess the impact (benefits and costs)—*direct and indirect*—of FDI inflow to Namibia.

5.1 Modelling the Effects of FDI

Most of the empirical work undertaken on the effects of FDI is based on the single equation approach using time series, or cross-section aggregated, or disaggregated data. Typically, the underlying model would consist of an equation in which the dependent variable is the variable hypothesized to be affected by FDI, while FDI, whatever the measure may be, appears as an explanatory variable. Other explanatory variables are used to control for the effect of other factors on the dependent variable. For example, Borensztein et al. (1995) investigated the effects on economic growth by specifying a relationship of the form:

$$g = f\,(I^{F}, H, Y_{O}, X) \qquad \textbf{(1)}$$

where g is the growth rate, I^F is foreign direct investment, H is the stock of human capital, Y_o is the initial level of output, and X is a vector of variables that are frequently used as determinants of growth, such as Government expenditure, and variables representing foreign exchange and trade restrictions. The implication of equation (1) is that growth rate is determined by FDI and other factors, and in this sense causality runs from FDI to growth. Now, we may want to compare this with models of FDI determination, such as the model used by Yang et al. (2000) specified as:

$$I^{F}_{t} = \alpha_0 + \alpha_1\Delta i_t + \alpha_2\Delta E_t + \alpha_3\Delta Y_t + \beta_4\Delta W_t + \beta_5 O_t + \beta_6 D_t + \beta_7 \Pi_t \qquad (2)$$

where i is interest rate, E is the effective exchange rate, Y is output or GDP (real), W is the wage rate, O is openness, D is a measure of industrial disputes, and Π is the inflation rate. The implication of Equation (2) on the other hand is that output (which is a proxy for market size) determines FDI, and hence causality runs from output to FDI.

It is more plausible, however, to postulate that both output and FDI are endogenous variables that affect each other within a macroeconomic system. Hence, a simultaneous equation system may be more appropriate as a representation of both the determination and the effects of FDI on a host country. Unfortunately, and as mentioned above, most of the empirical works on the effect of FDI is based on the single equation approach, but for one notable exception, that is, Petrohilos (1989). He specified and estimated a simultaneous equation econometric model designed to show the effect of capital formation on the growth of output in general, and the influence of FDI in particular. In this model, FDI is an endogenous variable which is determined within the system while affecting the other variables such as private consumption, gross private domestic investment, gross private residential investment, other gross private investment, total gross investment, imports of capital goods, imports of raw materials and intermediate goods, manufacturing output, non-manufacturing output, personal disposable income and gross domestic product. The models were estimated using linear and log-linear specifications and Greek data by employing more than one estimation method.

Ordinarily, it would have been a better idea to undertake the last type of analysis—simultaneous equation system—in order to be able to fully capture the benefits and cost of FDI in Namibia (since the literature is almost inexhaustible on the single equation technique). This could not be achieved moreover given time, data, and cost implications of such an exercise. We therefore had to resort to the use of descriptive analysis of macro and micro data, and a cost benefit analysis, which to a large extent, provide quite useful results. Ultimately moreover, we still will recommend the simultaneous equation analysis as a more meaningful and extensive exercise in the nearest future.

It is important to mention that an extensive descriptive analysis of the cost and benefit of FDI on a host country is one that is able to elicit the transmission mechanism in the forms of:

(a) the impact of FDI on investment and savings of the receiving sector;

(b) the indirect impact on investment and savings of other sectors;

(c) the effect on inflation and through this, on the real exchange rate and exports;

(d) the impact on debt burden—in cases where capital flight are proved; and

(e) the effect, resulting from the factors listed, on economic diversification, employment growth and overall development.

In what follows, we have attempted, given available data, to conduct the descriptive analysis along the lines suggested by the above transmission mechanism.

5.2. The Benefits of FDI to Namibia – Analysis using Macro Data

A sustained increase in productivity or an expansion of production capacity represent two of the most important factors needed to achieve long-term economic growth. The expansion of a country's production capacity requires additional investment or capital formation. Previous studies have indicated that a high ratio of investment relative to gross domestic product (GDP) is one of the most important preconditions for achieving sustained high economic growth. In this regard, we show in Table 5 how Namibia and other SACU countries have faired in terms of the proportion of inward FDI stock in gross domestic product for the period 1980 to 2004. The table reveals that compared to other SACU members, the incentives and policies of attracting FDI in Namibia has paid off well. For 2000 and 2004, inward FDI as percentage of GDP was over 30 percent in Namibia; well above the Southern African average of 22 percent. Directly or indirectly, this inflow of FDI, coupled with the other Governmental interventionist policies may have spurred the growth of Gross Fixed Capital Formation (GFCF) in the country. Table 6 and Figure 1 show that Namibia witnessed sustained growth in GFCF for the entire period 1993 to 2004. Even though mining and quarrying and manufacturing were the dominant recipients of investments between 2003 and 2004, earlier periods witnessed sustained investments in two other sectors—Transport and Communication; and Finance, Real Estate and Business Services. Furthermore, Figure 2 shows that compared to other Countries and regions of the world in 2004, Namibia was second only to Swaziland in terms of the proportion of GFCF in inward FDI flows.

Table 5. Inward Foreign Direct Investment Stock as a Percentage of Gross Domestic Product (GDP) (1980-2004)

	1980	1990	2000	2001	2002	2004
World	6.7	8.4	18.3	21.2	22.3	21.7.
Developed Countries	4.9	8.2	16.3	17.9	18.7	20.5
Europe	6.2	10.8	26.5	30.4	31.4	32.0
Developing Countries	12.6	9.8	26.2	33.4	36.0	26.4
Africa	8.2	12.7	26.5	28.5	30.6	27.8
Latin America and the Caribbean	6.5	10.5	24.7	36.2	44.7	34.1
South East Europe and the CIS	..	0.2	15.8	19.1	20.8	21.5
Asia	17.9	8.7	26.9	32.7	33.3	23.2
Least Developed Countries	3.1	5.8	18.5	21.8	23.4	24.4
Southern Africa	..	10.9	34.2	..	..	21.9
Botswana	61.8	34.8	36.6	28.5	38.6	15.1
Lesotho	1.2	13.5	38.2	64.5	75.3	31.6
Namibia	86.4	80.9	35.6	25.2	34.1	32.6
South Africa	20.5	8.2	33.9	44.0	48.7	21.7
Swaziland	41.8	39.9	38.6	37.1	54.6	39.2

Sources: UNCTAD, 2005 and World Bank 2006.

The next question then remains as to how far this investment regime translated into improved economic activity in Namibia. Table 7 and Figure 3 show that even though the Government sector contributes a sizeable proportion to GDP—understandably so, given the need to invest in social services and infrastructure—unlike other countries in the region, Namibia has succeeded thus far in its efforts at diversifying the economy. The manufacturing sector contributes more than mining and quarrying to GDP over the period 1995 to 2005; while wholesale and retail trade, real estate and business services as well as the transport and communication services continue to be dominant forces in the Namibian economy. This is an indication that the efforts of the Government at sustained diversification of the economy are achieving desired positive results.

Table 6. Gross Fixed Capital Formation by Activity (Constant,1995 Prices)- N$ Million

Sectors	**1993**	**1994**	**1995**	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**
Agriculture	93	125	135	159	182	192	200	209	219	230	243	259
Fishing	77	11	79	90	48	126	121	124	172	187	164	174
Mining and quarrying	298	233	302	540	393	429	536	656	697	638	1,971	1,068
Manufacturing	297	241	232	232	256	364	244	296	333	1,212	979	1,058
Electricity and water	68	68	64	137	119	209	339	99	848	186	465	398
Construction	61	115	118	126	130	194	131	124	132	149	162	177
Wholesale and												
retail trade;	68	171	316	198	156	163	121	171	218	194	152	200
hotels, restaurants	68	171	316	198	156	163	121	171	218	194	152	200
Transport, and communication	155	249	207	259	405	762	865	506	420	803	599	643
Finance, real estate, business services	538	599	642	880	437	425	419	479	509	526	624	696
Community, social and personal services	22	23	26	21	25	41	19	13	15	21	20	21
Producers of Government services	615	611	694	666	715	658	718	700	731	660	588	704
Total	**2360**	**2617**	**3131**	**3506**	**3022**	**3726**	**3834**	**3548**	**4512**	**5000**	**6119**	**5598**

Source: Central Bureau of Statistics

Note: Series prior to 1993 are based on 1990 base year while those from 1993 onwards are based on 1995 base year

Figure 1 Gross Fixed Formation by Activitiy, 1993-2004 (Constant 1995 Prices)

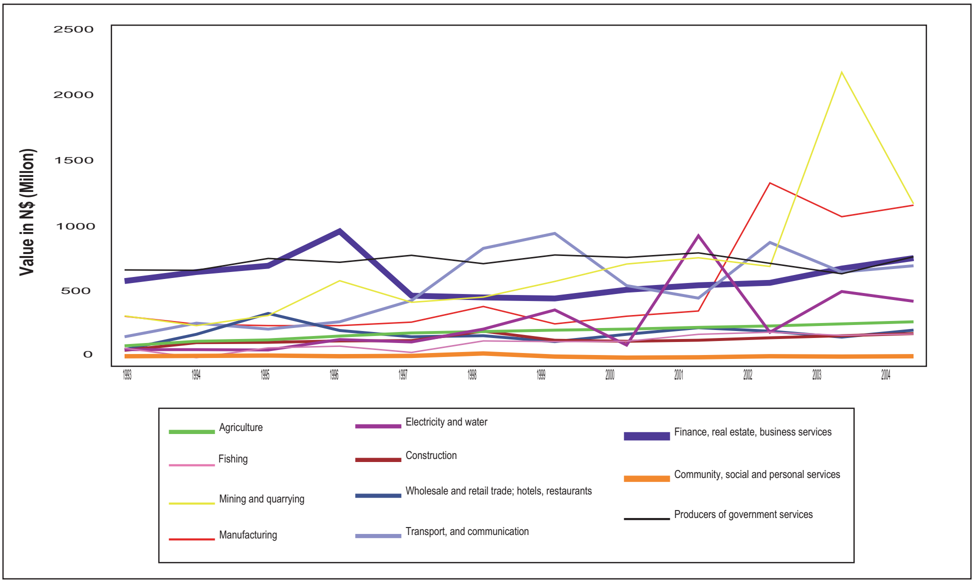


Figure 2.Inward FDI Flows, 2004 (Share of GFCF)

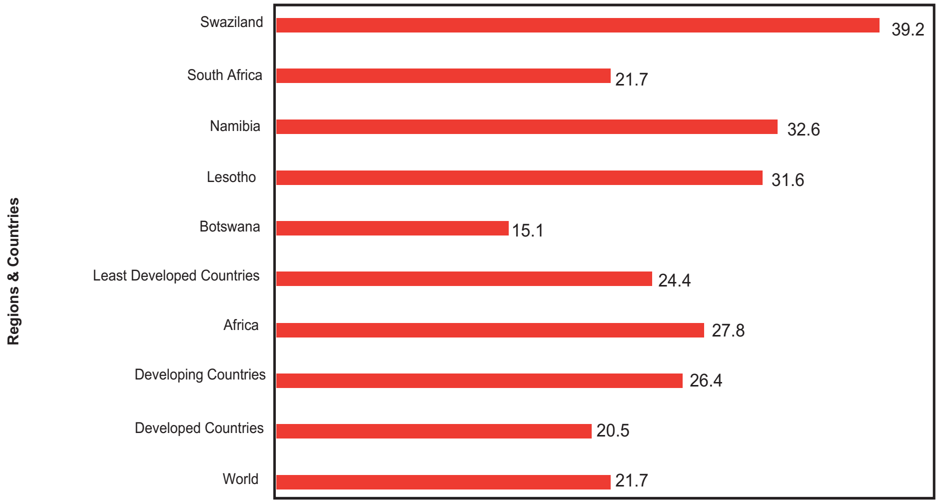


Table 7. Gross Domestic Product by Economic Activity (Selected), 1995-2005 (Percentage Contribution)

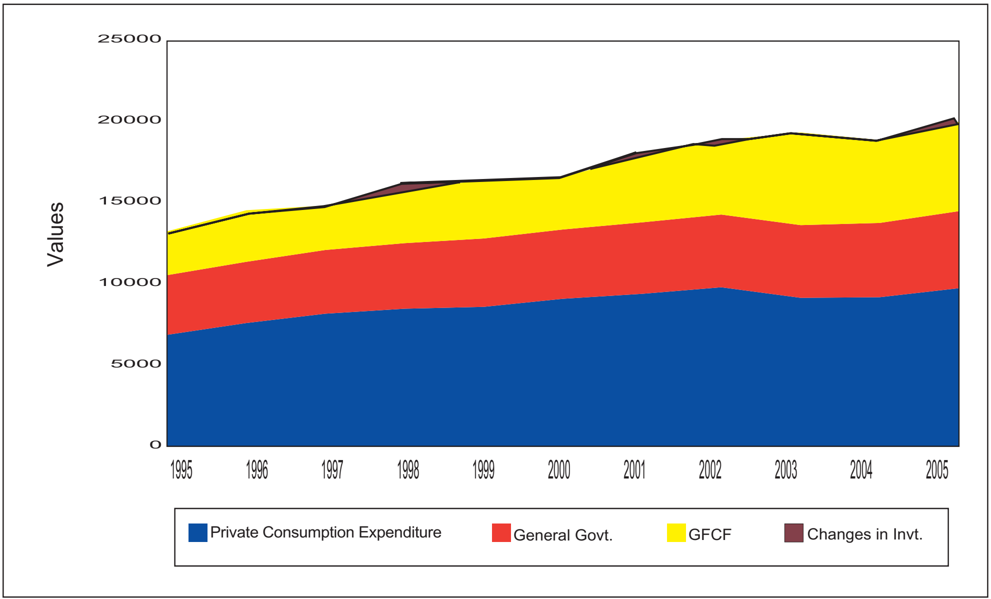
Industry (Selected)	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Agric and Forestry	6.9	6.5	5.8	4.8	5.3	5.5	4.1	5.1	5.4	5.2	6.3
Mining and Quarrying	8.3	10.3	10.3	9.8	9.4	11	13.2	13.9	8.8	9.7	9.3
Manufacturing	11.5	8.9	9.9	10.9	10	10	9.4	10	11.4	11.5	11
Electricity and Water	2	2.1	2.1	2.4	2.6	2.6	2.2	2.6	3	3.3	3.6
Construction	2.8	3	2.6	2.8	2.3	2	2.8	2.2	3	3.1	3.3
Wholesale & Retail Trade	8.5	8.7	9	9.2	9	11.3	10.8	10.4	11.8	10.8	10
Hotels and Restaurant	1.7	1.5	1.8	1.9	1.7	1.7	1.7	1.7	1.9	1.8	1.7
Transport and Communication.	6.7	6.5	6.5	5.9	5.9	5.8	5.5	6.3	7	7.3	7.4
Financial Inter.	2.6	3.2	3.6	3.4	3.6	3.5	3.5	3.3	3.7	3.4	3.8
Real estate and Buss	9.7	10.2	9.7	9.6	9.8	9.4	9	8.6	9.3	9.5	9.3
Community and Social	0.9	0.9	0.9	0.8	0.8	0.8	0.8	0.7	0.8	0.8	0.9
Producers of											

Source: Research Department, Bank of Namibia.

Furthermore, Figure 3 shows that private consumption expenditure, for the entire period 1995-2005 was relatively very high as compared to Government consumption expenditure; and generally trended upward with gross fixed capital formation. Since economics principles seem to suggest that high Government consumption expenditure is a reflection of large size of Government in an economy—a situation that may tend to crowd-out private investment—the relatively higher levels of private consumption expenditure may be viewed as a positive indication that FDI inflow is positively associated with growth in domestic investment (crowd-in effect) in Namibia.

This figure suggests that the private sector of the economy has been very vibrant, (albeit on the assumption that these figures are composed of salaries and other variable costs in the private sector as opposed to household consumption expenditure); and have positive impacts on national income in the ultimate.

Figure 3.GDP Expenditure (Real) N$ Million



5.3. Other Benefits of FDI – Micro Analysis using the EPZ Scheme

In addition to the favourable increase in the levels of exports, employment and investment recorded in the economy since the 1990s (Kaakunga and Kadhikwa, 2006), the EPZ scheme had also benefited the economy in the form of linkages between the EPZ companies and domestic companies. EPZ companies use the facilities of Namibia Port Authority (NAMPORT) and TransNamib Holdings

(TRANSNAMIB) in order to transport their goods within and outside the country. This has boosted revenue for these companies especially TRANSNAMIB which operates railway and therefore haulage services for goods shipment between various commercial centres in the country.

With respect to technology transfer, EPZ companies as well as administrators of the EPZ regime agree that there have been significant transfer of technology and skills from EPZ firms to the domestic economy. Managerial practices and notions of quality control are inevitably transferred to the local middle managers whom EPZ firms employ. This suggests that the training they receive confers a benefit to the domestic economy which may not be fully captured in the wages they receive in the EPZ zone. Data from 2 companies which have submitted their employment profiles to the Employment Equity Commission indicates that 48 Namibians are holding management positions while 107 Namibians are in specialised senior positions.

A project worthy of assessment under the EPZ regime is the Skorpion Zinc project. This project injected around N$4.3 billion into the Namibian economy and created 600 direct jobs in the Karas region alone and an additional 400 contract employees. The Skorpion mining company is taxable in terms of the Namibian tax regime and also pays royalties to the Ministry of Mines and Energy (MME). It also generates income taxes to the coffers of the Government under the PAYE system by its employees. The estimated multiplier effect is estimated to be in the region of about 2.5 percent of GDP.

5.3.1 Investment, Exports, Output and Employment from the EPZ

Available statistics shows that investment has steadily risen over the years from a mere N$143 million in 1999 to N$5.56 billion in 2004. On average, Namibia recorded an average inflow of foreign direct investment to the EPZ regime of about N$305 million per year during the last six years. The significant inflow of investment witnessed in 2001 was made possible by projects such as the Skorpion Zinc Refinery, Ramatex and Namcot Diamonds.

Turning to exports, since 1998, the export performance of the companies under the incentives schemes has also grown steadily, even though not at expected magnitude. From around N$50 million in 1998, the export figure increased to N$1.4 billion in 2001. However, this was to decline to N$657 million in 2002, but rose again to around N$744 million in 2003. The slowdown in exports during the period 2002-2003 could be explained by the closure of one of the EPZ companies in the textile industry. Moreover by 2004 exports by EPZ companies improved dramatically and peaked at a level of N$3.1 billion. This encouraging turn of events was a result of the coming on stream of some textile and apparel factories that benefited from both the export processing zone incentives as well as the export of products under the African Growth Opportunity Act (AGOA).

Furthermore, companies operating in the EPZ regime accounted on average for 21 percent of total manufacturing output for the period 2002-2004. The main driver of this significant contribution to manufacturing output is textile production which commenced in 2002 and reached full production capacity during 2003. On average, economic activities of companies operating in the EPZ regime accounted for 6.3 percent of Namibia's GDP for the period 2002-2004. A major peak was observed in 2003—EPZ output increased from N$801 million to N$3.7 billion— representing a growth rate of 364.7 percent. This development was due to a major EPZ investment in the textile industry which achieved full production capacity during the period.

The significant increase in foreign investment flows into Namibia may also have led to sustained employment generation in the last decade or so. Available statistics reveal a significant shift in sectoral distribution of FDI inflow; away from the mining sector which had hitherto being the attracting sector. This shift could also be explained by the sizeable investment made by tow companies; Ramatex and Skorpion Zinc companies.

5.4 Cost - Benefit Analysis of the EPZ Scheme

Cost-benefit analysis is one of the many available techniques of evaluating the feasibility or otherwise of projects—private or public—in order to make informed economic decisions. In this regard, the discounted stream of costs and benefits are computed and compared over the expected life span of the project[13]. The first step in the cost-benefit analysis methodology in this case, is to identify the costs and benefits to Namibia due to investment incentives offered to companies operating under both the EPZ regime and the manufacturers and exporters incentives schemes. The second step is to discount the identified costs and benefits of investment incentives by means of an appropriate discount rate.

The purpose of discounting the Namibia Dollar (N$) value (i.e. monetary value) of the identified costs and benefits of investment incentives to Namibia is to translate

13 This and other project evaluation techniques are explained in standard Economics and Project Evaluation textbooks, please see www.economist.com, the A-Z of economics.

benefits and costs occurring over different time periods to a common unit of measurement. Furthermore, in order to compute the net present value (NPV) of the costs and benefits, it is essential to discount them. Discounting reflects the time value of money[14]. The four year average nominal interest rate on the Government of Namibia longest dated bond (GC24) was used in this analysis as a discount factor/rate because it assumed that to fairly approximates the opportunity cost or alternative return on investment, assuming that EPZ companies would have invested their funds in the domestic capital markets on a long-term basis.

The third step in the cost-benefit analysis is to calculate the difference between the NPV of identified benefits and costs of investment incentives, respectively. If the net position is positive, this implies that, investment incentives have been beneficial to Namibia and vice versa.

The following benefits that could accrue to the Namibian economy as a result of offering incentives to businesses operating under the EPZ regime were identified as:

- Increased exports of manufactured goods; (i.e. N$ value of exports by EPZ companies);
- Attraction of foreign direct investment (i.e. N$ value of investments by EPZ companies);
- Operating expenses[15] (i.e. N$ value of cost of sales, wages and salaries, etc) EPZ companies.

Furthermore, the following costs have also been identified:

- The monetary value (i.e. N$ amount) of subsidies for example on the usage of electricity and water provided by the Windhoek municipality to selected EPZ companies.
- The tax forgone by the Government of the Republic of Namibia as a result of the tax free status that companies operating in the EPZ regime are

14 The idea that money available at the present time is worth more than the same amount of money available in the future, due to its potential earning capacity. This core principle of finance holds that, provided money can earn interest, any amount of money is worth more the sooner it is received.

15 The day-to-day expenses incurred in running a business, such as sales and administration, as opposed to production costs.

entitled to (i.e. N$ value of tax forgone by the Government as a results of exempting EPZ companies from paying corporate income taxes).

In analyzing the net present value (NPV) of benefits and costs of companies operating under investment incentives, we have employed the following equation

$$NBC_t = (N\$X_t) + (N\$1_t) + (N\$OE_t) - (N\$S_t) - (N\$T_t) \qquad \textbf{(3)}$$

Where;

NBC_t = represents the net benefit cost position;

$(N\$X_t)$ = the Namibia Dollar value of exports by the EPZ companies;

$(N\$1_t)$ = the Namibia Dollar value of investment by the EPZ companies;

$(N\$OE_t)$ = the Namibia Dollar value of the operating expenses of EPZ companies;

$(N\$S_t)$ = the Namibia Dollar value of subsidies expenses by the Windhoek Municipality

$(N\$T_t)$ = The Namibia Dollar value of taxes forgone by the Government due to granting companies tax free EPZ status.

If the following condition is satisfied

$$NPV = \sum_{t=1}^{t=T} \frac{NBC_t}{1+r} > 0$$

then it implies that investment incentives have been beneficial to the Namibian economy, that is, if the sum of the net present value of the is positive, an excess of benefits over costs is reflected for the year under consideration and thus the EPZ regime has yielded positive results for the Namibian economy.

Table 6 shows the results derived from the cost-benefit analysis. The results indicate that on average, the country derived net benefits from companies operating in the EPZ regime amounting to N$14.8 million for the period 1998-2004 as represented by the three measured benefits of exports, investment and operating expenses. However, it is imperative that these results should be interpreted with utmost caution, since as previously explained, some of the costs and benefits of investment incentives could not be monetized; for instance technology transfer, skills development and administrative costs.

Table 8. The Net Present Value of EPZ Benefits and Costs (N$)

	NPV of Benefits (Million)	NPV of Costs (000)	Net Benefits/Costs Position (Million)
1998	2.5	277.7	2.2
1999	1.8	652.9	1.1
2000	2.5	688.9	1.8
2001	14.1	870.5	13.2
2002	35.4	1.4	34.0
2003	29.9	16.7	13.2
2004	38.1	131.2	37.9

Source: BoN Calculations.

5.5 Costs of FDI in Namibia

FDI, Productivity and Employment

Even though we were unable to lay our hands on more recent data, table 9 reveals that the impact of MNCs on employment and productivity may actually not be as encouraging as expected. The reason for this is that MNCs tend to use more modern capital-intensive technology than local enterprises (Iyanda, 1998). As a result, their employment generating capacity for any given level of investment may turn out lower than that of indigenous companies. An analysis of investment in the EPZ scheme undertaken by Iyanda (1998) revealed that while foreign-owned companies created seven jobs per N$1 million invested, the corresponding figure for local companies is 18.

Similarly, the same study revealed that in industries where foreign companies have a relatively high profile, the amount of fixed assets per employee was much higher than in the case of those industries with only a few foreign companies. Table 9 further shows that the average size of fixed assets for each establishment and the average fixed assets to create jobs are much higher in industries with relatively high foreign participation than those with relatively less. This means that whereas FDI might help to raise productivity in industries, they tend to create fewer employment opportunities than indigenous enterprises[16].

16 It is important to mention moreover that this data is rather outdated. The situation may have since changed and more recent data can only confirm or refute our assertions here.

Table 9 FDI, Productivity and Employment in Namibia (1994-95)

Industry	percent of cost with FDI	Employee per establishment	Fixed assets/ Establishment (N$'000)	Output/labor ratio (N$'000)	Fixed asset/ Employee (N$'000)
Food and Beverages	15	127	10563	192.6	83.2
Textile, wearing apparel, leather	22	42	525	48	48.1
Wood & wood products	0	42	1274	61.8	30.3
Paper & paper products	10	47	1843	96.8	39.2
Chemical & chemical products	29	38	3701	258.8	97.4
Non-metallic mineral products	18	42	2145	84.2	51.1
Metal products, machinery & equipments	12	40	2600	136.4	65
Others	25	17	305	21.7	17.9
Manufacturing total	na.	77	5607	168.7	72.8

Source: Iyanda (1998) and, Report of census of manufacturing establishments, 1994-95

5.5.2 FDI and Regional Imbalance in Development

Generally and as previously mentioned, the availability of infrastructure—paved roads, telecommunications, electricity, health facilities, safe drinking water, etc.—as well as paid-employment opportunities, industries and institutions of Government, are biased towards urban areas and capital cities; particularly in Africa. Namibia is not an exception in this regard—Windhoek in the Khomas region being the capital city and the only large urban centre in the country. As reported in Iyanda (1998), even though the coming on stream of the EPZ scheme in Namibia is supposed to even things out, situation on ground seems to suggest that EPZ investments have been concentrated in cities and towns such as Walvis Bay, Swakopmund, Tsumeb, Keetmanshoop and Otjiwarongo. All theses cities—preferred location of FDI investments—are in the four regions which account for 98 percent of value added in manufacturing in Namibia. This then seems to reinforce the arguments that FDI inflow and MNCs in manufacturing tend to exacerbate regional imbalances since they locate in the relatively well developed regions with developed infrastructure.

Table 10 which shows the disparity between the most developed and least developed regions of Namibia evidently reveals that the four most developed regions account for just about a quarter of the population of Namibia; but on the other hand, attract the highest percentages in terms of employment, manufacturing establishments and value added activities (Iyanda, 1998). The five regions with more than half of the population of the country account for only about 5 percent of manufacturing establishments, 1.1 and 0.7 percent of employment and value added respectively. Furthermore, since mining activities are inevitably determined by the presence of natural resources, towns such as Oranjemund, Gobabis, Karibib, Arandis, Luderitz and Tsumeb owe there existence and development largely to mining.

Finally, Table 10 also reveals regional imbalance in terms of average earnings in Namibia that may be associated with FDI location. The table shows that in 1993-94, the average regional income in Khomas region was N$11,359 (about three times the national average of N$3,608). The same region also had a literacy rate of 84 percent, the highest in the country for that period.

Table 10. FDI and Regional Imbalances[17]

Regions	Population	Percentage Distribution		Value added	NS Income 1993-94	Literacy (percent)
		No. of Manufacturing Establishments	No. of persons engaged			
Developed	27.5	85.4	96.3	98.2	Na.	Na.
Erongo	4	23.4	41.5	37.1	5423	81
Otjozondjupa	7.3	19.7	11.6	12.9	3659	58
Khomas	11.8	37.2	26	40.4	11359	84
Karas	4.4	5.1	17.2	7.8	6655	82
Undeveloped	53.2	5.1	1.1	0.7	na.	na.
Omusati	13.5	0		0	1452	68
Ohangwena	12.7		0.0	0	1070	51
Oshana	9.6	1.5	0.4	0.1	1922	70
Oshikoto	9.1	2.9	0.6	0.5	1680	61
Okavango	8.3	0.7	0.1	0.1	1763	55

Source: Iyanda, (1998)

5.5.3 Net Savings as a Proportion of Gross Fixed Capital Formation

In Figure 4 we have tried to examine the proportion of gross fixed capital formation (total investment in the Namibian economy) that derives from net domestic savings for the period 1995-2005. This is with a view to isolating that part of total domestic

[17] Data Reported in this table are obviously outdated. There is no doubt that the situation may have changed. An updated data will reveal the current situation of things.

investment emanating from domestic savings vis-à-vis capital from abroad. This, not only sheds light on the vibrancy of the domestic capital market, and particularly the Namibian stock exchange, but also supports the argument for the mobilization of domestic financial resources for investment rather than relying on funds from abroad. The data reveal that net domestic savings contributed well over 90 to GFCF for the entire period. Since these are national accounts figures, this may in no way contradict our earlier submission of the contribution of FDI inflow in overall capital formation in the country. In addition, it may also reflect the impact of the introduction of Regulation 28 of the Pension Funds Act.

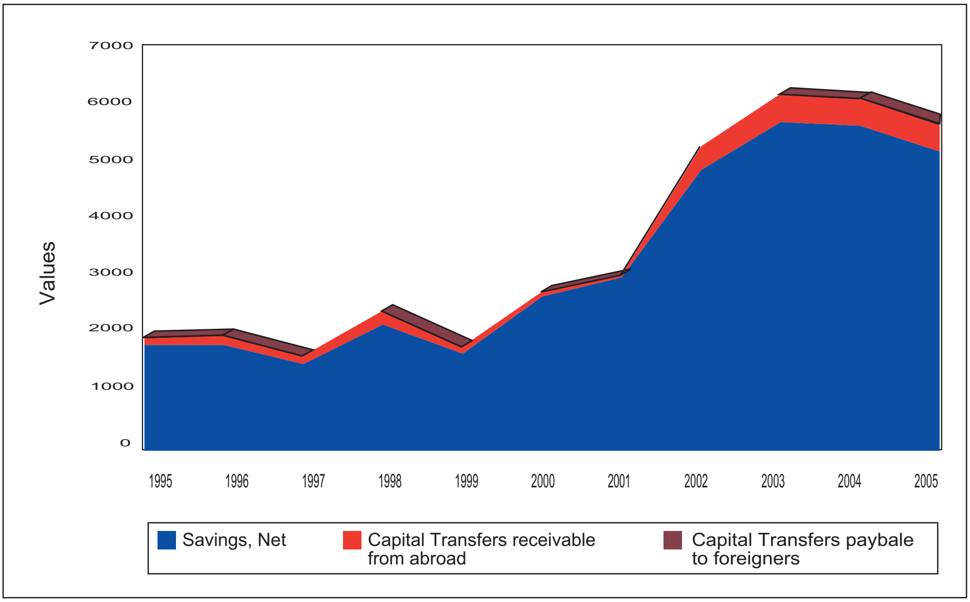
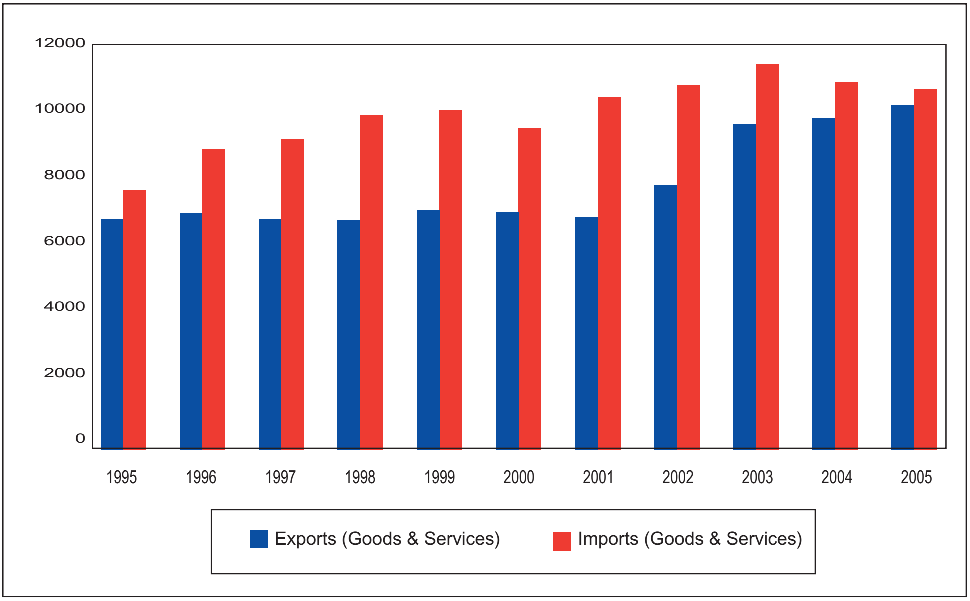


Figure 4. Financing of Gross Fixed Capital Formation (N$ Million) 1995-2005

5.5.4 FDI, the Current Account Position and Sectoral Employment Imbalances

As posited in the theoretical literature, FDI may to some extent lead to balance of payments problems—the so called import and remittances effects. Figure 5 shows that for the entire period 1995-2005, Namibia recorded deficits in its trade account. Even though many other macro and micro economic factors might have accounted for this, the argument here is that if FDI had as expected led to substantial increases in exports, the deficit situation may have been averted. But of course, it is also plausible to argue that, but for FDI inflow into mining and manufacturing; and the induced exports growth, the deficit situation may have been worse than revealed in figure 6.

Figure 5. Exports and Imports of Goods and Services (Real), N$ Million [18]

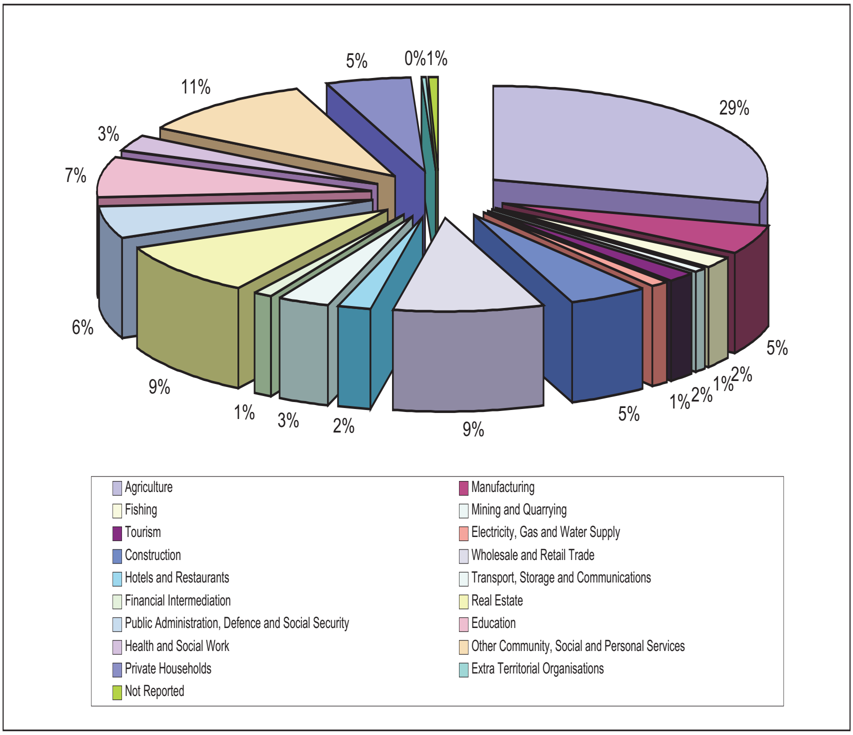


In terms of employment generation, it is no gainsaying that the major sectors of the Namibian economy in which MNCs have been very active are mining and quarrying, manufacturing and wholesale and retail trade. Even though the expectation of the Government is that of an economy that is more diversified and particularly dominated by manufacturing—which has the greater potential for employment creation—the situation has not been so as shown in Figure 6. According to the Labor force survey, 2002, Agriculture continues to dominate the job market (29 percent); whereas manufacturing employed just about 7 percent; wholesale and retail trade and mining (about 9 percent respectively). This may be an indication of the fact that direct policy measures that will set the country on a path of sustained

[18] Data reported in this table are obviously outdated. There is no doubt that the situation may have changed. An updated data will reveal the current situation of things.

industrial development are still required. FDI inflows may not be the only reliable avenue to achieve this national objective.

Figure 6. Sectoral Employment in Namibia, 2002



5.6 Costs and Benefits of FDI – Case Studies

In Box 1 and Box 2, we have presented two case studies of FDI projects—Box 1 for Namibia and Box 2 for South Africa. Box 1 highlights the case of Ramatex Namibia—and the benefits and costs associated with it. This is a true story of a multinational corporation currently in operation in Namibia. It has generated employment opportunities, contributed to export and foreign exchange earnings but

BOX 1: RAMATEX IN NAMIBIA: THE BENEFIT AND COST STORY

Ramatex is Malaysia's leading textile enterprise, with operations in Cambodia, South Africa, Mauritius, and China and 2004 turnover of US$300 million. Its investment in Namibia has been the largest ever by a foreign investor in manufacturing. Following six months of negotiations with the Ministry of Trade and Industry and the City of Windhoek, in 2001 Ramatex started construction of a fully integrated garment and textile plant in the Otjomuise area. Other stakeholders involved in the project include the Namibia Investment Centre, the Off-Shore Development Company, NamPower, NamWater and Telecom Namibia. Authorities expected the Ramatex investment to add value to Namibian manufacturing, diversify exports, create opportunities for skills training and entrepreneurial development, promote SMEs, and stimulate economic growth. The city agreed to lease a 43-hectare portion of land at no direct cost and exempt Ramatex from land use tax. Since the site had already been earmarked for development as an industrial location, funding had been prearranged with the Development Bank of Southern Africa.

Given limited availability of skilled workers, Ramatex was expected to provide the necessary training. Talking about local staff, Malaysian investors said: "If they are prepared to work harder, if they are keen to learn, to be well-disciplined, if they are responsive to supervisors' instruction, they could be trained and become skilful sewers. The aim is to instil discipline, punctuality, high productivity, good quality and a culture of hard work. What we want is discipline, and hardworking Namibian people that can be equated to China when comes to garment manufacturing". In February 2003 two of the four buildings started production, each housing more than 1,000 workers. By early 2006 Ramatex was employing about 4,000 Namibian workers and a further 2,000 foreigners.

The project, however, also raised various issues of concern. Ramatex had not released the results of an Environmental Assessment, although Namibian legislation requires it for all new projects before approval. Ramatex was at times allowed to by-pass basic workers' rights, the Namibian Labor Act, the Affirmative Action (Employment) Act, as well as environmental and municipal regulations. Ramatex never increased workers' wages despite signing a recognition agreement with the Namibia Food and Allied Workers Union (NAFAU) in 2002

BOX 1: RAMATEX IN NAMIBIA: THE BENEFIT AND COST STORY(CONT)

that it would increase salaries after workers had been employed for three years. In May 2003 about 700 Asian employees, mostly from China, went on strike demanding a salary increase and better working conditions. Separately, more than 400 Namibian workers were suspended after a spontaneous strike. In September 2004, the Government deported more than 400 Bangladeshi workers after it was discovered they had been working without proper permits and living in unsuitable conditions.

Although President Sam Nujoma defended Ramatex saying staff were still being trained, the Congress of Democrats, in opposition, and the International Textile Garment and Leather Workers' Federation (ITGLWF) have expressed concerns about workers' treatment. The ITGLW further appealed to all US buyers of Namibian textiles to "intervene to bring pressure to bear on the company to put in place a corrective action program to address such appalling labor practices and workers rights' abuses". With the end of the MFA in December 2004, the factory has experienced a 36 percent drop in exports since 2004. Rhino Garments, a subsidiary of Ramatex, closed in April 2005, citing NAFAU's connections to the ITGLWF as the reason for the closure. Ramatex is rumoured to consider shutting down its Windhoek operations completely.

Sources: Goldstein (2004a), Jauch (2005), and "Rumours rattle Ramatex", Namibian, 7 April 2006, and Andrea Reproduced with permission from: Goldstein, A. (2006), Emerging Multinationals in the Global Economy, Palgrave Macmillan (forthcoming).

BOX 2: DAIMLER CHRYSLER-- SISAL FIBER PROJECT SOUTH AFRICA

Based in East London DaimlerChrysler South Africa manufacturers cars and vehicle components for domestic and international markets. With nearly 4000 employees and a state-of the-art manufacturing facility, DaimlerChrysler is one of the biggest employers in the Eastern Cape region. The subsidiary is wholly-owned by DaimlerChrysler Germany, making the corporation one of the largest German investors in South Africa.

DaimlerChrsyler SA is spearheading a project to “green” its supply chain by switching to natural fibers in vehicle components. Early in the 1990s, DaimlerChrysler (then Mercedes-Benz) declared a commitment to environmental sustainability, including by improving its products and processes. Company research identified a number of natural fibers—flax, hemp, coconut, cotton and sisal—as best in meeting both environmental and manufacturing requirements. A German firm, Johann Borgers GMBH & Co (Borgers), who developed the technology to process and manufacture flax and cotton fibers. DaimlerChrysler SA’s objective, however, was not to import natural fibers processed and manufactured in Germany, but to establish an entire local supply chain based on sisal. The South

African supply chain would include:

• Sisal farming

• Processing of sisal fibers

• Manufacture of sisal components

• Release to DaimlerChrysler SA.

The “produce locally” decision was driven by South Africa’s local content policies, which place a duty on imported components used in local manufacture of vehicles. Local content in exports of vehicles and components, on the other hand, earns credits which offset import duties. “Local content,” in this regard, “is therefore critical to the business in South Africa, and has spurred the active involvement in technology transfer projects that promote the use of South

Box 2: Daimler Chrysler-- Sisal Fiber Project South Africa (Cont)

African resources". The multifaceted project required multiple partners, initiatives, and agreements. DaimlerChrysler oversaw the technology transfer part of the project. Two well-established South African firms, Brits Textiles and NCI, were identified as recipients of the technology owned by Borgers. Brits gave Borgers a one-time payment of $80,000 for the processing and manufacture technology. NCI—which already had a technology agreement with Borgers--agreed to a 2 percent royalty on revenue generated to retain their technological support. The technology transfer was successful, despite some bumps stemming from differences in business styles and communication cultures. For example, DaimlerChrysler's procurement team had to work with one supplier to "ensure that they would not continue to cut corners to save production costs". The first sisal component was released for inclusion in the Mercedes-Benz C-Class vehicles in October 2001 and sisal-cotton mixtures are now used substantively in local production. Both of the local South African companies have been strengthened as a result of the technology transfer. Thirty new jobs have been added. Brits textiles has entered a new business field and developed new industry contacts and opportunities.

NCI has had an increase in turnover and a greater international exposure as a supplier in natural fibers. There have also been spin-off businesses from the initial project, including applications in buildings and civil engineering projects.

Less successful has been the effort to develop a reliable local supply of sisal. South African farms produce only 500 tons a year, leaving an import requirement of about 2,500 tons. There are 23 state-owned and one operating commercial sisal farms. Two other commercial farms ceased operations due to labor problems. The problem is that the productivity of the state-owned farms is very low. DaimlerChrysler contracted with the Council for Scientific and Industrial Research to examine options for privatization, as well as additional markets and applications for sisal fibers. However, as of 2002, local sisal harvesting remains the sticking point in the local supply chain. "As long as the farms under perform, and cannot supply reliable amounts," concludes the study, "the success of the project is in jeopardy".

Source: Zarsky, L & Gallagher, K (2003). Searching for the Holy Grail? Making FDI Work for Sustainable Development. Paper prepared for a WWF-UK Workshop on International Investment Frameworks for Sustainable Development: Framing the Debate, London, March 10 its operations have also carried with it some costs to the country. This story captures to a very large extent the theoretical issues related to FDI as previously highlighted in this paper. Furthermore in Box 2, we also have presented another case study of FDI in South Africa, the Daimler Chrysler-Sisal Fiber Project.

6. Summary, Conclusions And The Way Forward.

6.1 Summary and Conclusions

In agreement with conventional development thinking, Governments in most developing countries—Namibia in this instance—try to attract FDI for expected beneficial effects on employment, exports growth, balance of payments, technology spillover, wages, sustained industrial and economic diversification, and overall development. They are usually not, or at least have not in the past been, concerned with costs that may also be associated with such inflows.

In this paper, the scepticism of the Washington consensus and the rather simplistic view taken by many mainstream economists that FDI is a sine qua non for economic development have been explicitly assessed; even in the face of limited data and daunting methodological challenge. We have highlighted the different arguments in the literature as to the fact that quite a number of drawbacks—costs—to host economies do arise from FDI inflow. Such drawbacks include: a deterioration of the balance of payments as profits are repatriated; a lack of positive linkages with local communities; potentially harmful environmental impact, especially in the extractive and heavy industries; social disruptions of accelerated commercialization; and the sometime harmful effects of competition in national markets. Furthermore, some expected benefits may even prove elusive if, for example, the host economy, in its current state of economic development, is not able to take advantage of the technologies or know-how transferred through FDI; and if as sometimes asserted, the positive effects are mitigated by a partial “crowding out” of domestic investment.

Though we were unable to matter-of factly prove many of these associated costs of FDI in this paper; given data and other limitations; we however, were able to use the available macro and micro data to reveal some positive effects and some costs.

Furthermore with the use of a cost-benefit analysis technique, based on figures obtained from a field survey of the EPZ regime conducted by the Research Department of the Bank of Namibia, we also examined the net benefit of the EPZ scheme. The results of the cost-benefit analysis show that Namibia has derived net benefits from companies operating under the EPZ regime; the series of investment incentives have attracted companies to Namibia, and have indeed assisted companies to raise a substantial amount of resources that enable them to produce a number of goods that have been exported. Additionally, the regional imbalances created by FDI in mining and manufacturing were shown, as well as the current account deficit and sectoral employment imbalance situations associated with the flows. We also showed using national income accounts figures that net domestic savings have been an important Source of domestic investment in Namibia in the last decade or so.

As it were, it becomes rather obvious that market forces cannot in any way substitute for the role of Governments in developing and promoting a proactive industrial policy. MNCs and FDI may well lead to an increase in productivity and exports, but they do not necessarily results in increased global or even regional competitiveness of the domestic sector or increased industrial capacity, which ultimately determines economic growth in the long run. FDI per se does not provide growth opportunities unless a domestic industrial sector exists which has the necessary technological capacity to profit from the externalities from MNC activities.

The main policy conclusion that can be drawn from this paper is that FDI is supposed to act as supplements to domestic investment and not as a substitute; the economic benefits of FDI are real and in most cases outweigh the costs; but they do not accrue automatically. To reap the maximum benefit from foreign corporate presence, a healthy enabling environment for business is paramount, which encourages domestic as well as foreign investment, provides incentives for innovation and improvement of skills and contribute to a competitive corporate climate. It is the host country authorities that must undertake basic efforts to raise education levels invest in infrastructure and improve the health of domestic business sectors. Domestic subsidiaries of MNCs have the potential to supplement such efforts, and foreign or international agencies may assist, for example through measures to build capacity. But the benign effects of FDI remain contingent upon timely and appropriate policy action by the relevant national authorities.

6.2 Specific Recommendations

As mentioned above, market forces cannot in any way substitute for the role of Governments in developing and promoting proactive policies for sustained development of key sectors of the economy. FDI inflows may lead to an increase in productivity and exports, but they do not necessarily result in increased global or even regional competitiveness of the domestic sector which ultimately determines the long run economic growth and sustainable development. FDI per se may not provide the growth opportunities in Namibia unless all the different sectors of the domestic economy are vibrant and dynamic. This is exactly the message of these specific recommendations. These recommendations must be viewed as addition to, and not substitutes for whatever monetary, fiscal, trade and industrial policies and programmes that Namibia already have in place.

6.2.1 Promotion of local resource-based industries

In the early 60s, many developing countries adopted import substitution production as a strategy for industrializing, promoting growth, and creating employment. Import substitution production is market-based, and often relies on imported inputs. Their impact on the economy is usually limited to the direct employment created and the wages paid. The result is an economy in which the industrial sector exists in an enclave, which exerted little or no linkage effect.

On the other hand, local resource-based investments produce a more dynamic economic development rather than just growth. Reliance on local input materials and other resources ensures the diffusion of the effects of the investments throughout the whole economy. Such diffusion serves as a catalyst for other developments, hence the initial employment created is multiplied several fold through secondary and even tertiary investment and employment in other sectors and geographical areas.

Government efforts to promote investments, both local and foreign, should therefore be more selective, focused on investments that are local-resource based or whose outputs are targeted at export markets. As such, investments should be sought for such industries as tannery, leather products, meat processing, mineral processing and jewellery, etc. Such industries will enhance the values of those local resources that are currently exported in less valuable raw state. In addition, they would create employment opportunities', diversify the country's industrial base, and enhance Namibia's export earnings An effective implementation of this strategy requires a detailed inventory of input materials (hides and skins, minerals, livestock etc) available in the country, the possible outputs from them, and the markets for such outputs. Efforts by the relevant investment promotion agencies (the Namibia

Investment Centre (NIC)) to promote local as well as foreign investments should then be directed at those aimed at utilizing such available resources.

A review of current laws and regulations that may prevent local or foreign investments in these sectors is however necessary. For example, the foreign investment legislation, the close corporations Act, workers' permit application procedure, the Regulation 28 of the Pension Funds Act, etc. Other laws and regulatory framework in other sectors of the economy will need to be reviewed if there is to be new investments in those sectors.

6.2.2 Export Orientation

Government realizes that in view of the small size of Namibia's domestic market, the required economic growth and development can come only from vigorous and sustained growth in international trade in goods and services. Consequently, reform policies are being aimed at raising productivity and efficiency of domestic resources, aligning the exchange rate of the domestic currency and thereby improving the international competitiveness of Namibia producers.

In addition to local resource-based industries, export-oriented industries promote growth and create employment opportunities. Because they add value to any inputs they might have imported, they are usually favoured with incentives and exemptions from import restrictions. The drive for FDI in particular should accord greater priority and efforts to industries that are engaged in production for the export market.

6.2.3 Tourism

Namibia already has a modest share of world tourism traffic. However, we believe that this sector has a much greater potential than is currently exploited. It is our view that a specialist study of the potentials in the industry needs to be commissioned and appropriate incentives offered to develop the industry. Currently, tourism seems to be geographically concentrated in the Walvis Bay. There is need to broaden the scope to other parts of the country as well as to encourage other forms of tourism beyond physical feature attractions and wild life.

6.2.4 Integration with SA manufacturing industries

The proximity to South Africa constitutes both an opportunity and a threat to Namibia. Potential investors in productive enterprises in the Southern African region, tend to favour South Africa, rather than Namibia, as their destination for a number of reasons—proximity to well developed and smooth functioning seaport, large domestic market, low cost of utilities, affordability and availability of investible funds, better infrastructure, higher technological skills and facilities. On the other side of the coin are the higher tax rate, the high crime rate and relative social instability, which constitute South Africa’s weaknesses. A proactive reaction to these two dimensions of the proximity to South Africa can turn both into an advantage.

Namibia can turn its relative disadvantage of size and lower level of technological development into an opportunity by integrating its industrial activities into those of South Africa. Integrated manufacturing agreements could be negotiated with selected major manufacturers under which Namibia would produce supply component parts to South African producers, instead of establishing production units of competing brands. Such agreements seem viable in such industries as motor vehicle manufacturing, electronic and household appliances, agricultural equipment etc. The initiatives for such contractual arrangements have to be facilitated by a Government to Government approach and negotiation, involving the relevant ministries, Government Departments and private sector organisation.

Namibia could also take advantage of its membership of the SADC and SACU in negotiating a “fair distribution” of industrial establishment within the Community and the Union. The concept of “fair distribution”, borrowed from the Cartagena. Agreement, (1969), is an attempt to deal with the issues arising from economic relationship between unequal regional partners with a view “to accelerate their growth and the rate of creation of employment and to facilitate their participation in the regional integration processes”. It substitutes a cooperative economic agreement for a competitive system, which ensures an equitable distribution of industrial enterprises among the various members of an economic Union rather than “winner takes all” system that is likely to characterise a competitive system. Furthermore, the development of infrastructure such as the Trans-Kalahari Development Corridor (TKDC) and the expansion of the Walvis Bay Airport will make the cost of transportation more affordable and competitive. Walvis Bay as a port could also then begin to attract more users such as Angolans, South Africans and Zambian business people amongst others.

One other dimension of proximity to South Africa relates to the differences in the macroeconomic environment of the two countries. Namibia offers a more stable social environment with a much lower crime rate and corporate taxation. It could therefore market itself as an alternative location to industries that are adversely affected by South Africa's adverse socio-economic environment. For such strategy to be successful, Namibia would need to set up industrial facilities or estates at border towns with South Africa and review it relevant policies and procedure to make them more attractive to target industries.

6.2.5 The Promotion of Small-Scale Industries

Small-scale industries have contributed significantly to the economic development and employment generation even in many developed countries such as Japan, India, Taiwan, Hong Kong and China. Apart from being more within the management competence of many citizens, they create more employment opportunities per a given level of capital investment and foster a more geographically balanced development.

The establishment of small-scale industries requires entrepreneurial skills and considerable information on technology, production processes, market opportunities, capital requirements etc. In most developing countries, citizens lack these skills. This makes it necessary for the Government to establish small-scale industrial centres to provide and enhance the information and skills required.

The mandate of the centre will include:

- Identifying prospects for small-scale industries in each district or locality of the country
- Preparing feasibility studies for identified opportunities. Such studies will provide, among others, information on production techniques and processes, capital requirements, availability of input materials, markets prospects for output, Sources and cost estimates of capital equipment, personnel requirements etc and making these available, at minimal costs, to those planning to establish small-scale industries.
- Providing support and advisory services to small-scale industries entrepreneurs, and,
- Initiating and promoting the establishment of legislation and policies conducive to successful operations and growth of small-scale establishments.

6.2.6 Government Role in the Economy

While economic planning has been important for Namibia's takeoff to sustained economic growth, the global shift has been towards a market economy in which the private sector plays the leading role. This suggests that central planning will increasingly lose its significance. Under this new economic approach, Government will have to move towards indicative planning. This would involve Government identification of priority sectors that, from both the domestic and global perspective, are expected to be major engines of growth in the future. The private sector would then be encouraged, through appropriate financial, fiscal and other incentives, to develop such industries.

The Government's facilitative role requires a closer relationship with and understanding of the private sector. In order to foster such understanding and relationship, Government needs to be more knowledgeable about the private sector. Such knowledge is best provided by periodic studies on the challenges industrialists' face which may constitute barriers to their growth or even survival.

Another area of study that could promote a closer Government-private sector relationship is the effectiveness of the incentives offered by Government. The failure of incentives in many developing countries generally indicates some measure of inappropriateness. Many of such were developed and offered to businesses without consultation with or reference to the target beneficiaries. Involvement of the potential beneficiaries of such incentives could reduce the divergence between the desired and the offered incentives increase their effectiveness and, ultimately, contribute to growth of the economy.

6.3 Future Research – Suggestions

As mentioned previously, the most appropriate method of undertaking this kind of research is the multi-equation simulation model technique that will fully capture the benefits and cost of FDI in Namibia. This could not be achieved here given time, data, and cost implications of such an extensive exercise. We therefore have recourse to the use of descriptive and cost benefit analysis, which in some respect yielded some useful results. These are the results reported in this paper. Ultimately moreover, we still will recommend the simultaneous equation analysis as a more meaningful exercise by the Bank of Namibia in the nearest future.

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COMMENTS ON MEASURING THE BENEFITS AND COSTS OF FOREIGN DIRECT INVESTMENT IN NAMIBIA,

BY

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Dr Oluyele Akinkugbe's paper on: "Measuring the benefits and costs of foreign direct investment in Namibia" comes after a very thorough analysis of the available international literature and the historic macro-economic Namibian situation in terms of foreign direct investments (FDI) and its impact.

Given the available information to Dr Akinkugbe the research paper is very comprehensive and informative. He came to the conclusion that: "FDI is supposed to act as supplements to domestic investment and not as a substitute; the economic benefits of FDI are real and in most cases outweigh the costs; but they do not accrue automatically."[19] Dr Akinkugbe emphasized in his paper that the available data had limitations and even the cost benefit analysis by the Research Department of the Bank of Namibia[20] should be treated with utmost caution.

Good policy can only be based on good information. For the purposes of this symposium one can thus come to the conclusion that all preliminary research results indicate that FDI was benefiting Namibia. However, more empirical research should be done to guide policy making in future. Dr Akinkugbe also recommends that research should be focused on a multi-equation simulation model technique to "fully capture the benefits and costs of FDI in Namibia".[21]

To prove conclusively the hypothesis that FDI is beneficial in Namibia one should address also the following complementary issues regarding FDI. Should investment by South African companies be included in the equation? Is this not FDI too? Secondly, should the argument not rather look at more explanatory variables of causation, albeit at different levels.

19 Akinkugbe, O. 2006: "Measuring the benefits and costs of FDI in Namibia", Discussion on Paper held at the Bank of Namibia 2006 Annual Symposium; p.42

20 Kaakunga, E. and Kadhikwa, G. 2006: "Evaluation of Investment Incentives in Namibia", Bank of Namibia, September 18, 2006 p.32.

21 Ibid, p. 47

Economists' tend to find recourse to simple models of causation to prove their argument and establish causation. They often start with the proximate causation that an increase in wealth (GNP) is a function of the reciprocal of the incremental capital-output ratio (a), the autonomous investment (Ia), the induced investment (Ii), the existing stock of capital and natural resources (K), and any increase in efficiency of exploiting this stock (k). This simple equation reads as follows:

$$dY = a\,(Ia + Ii) + Kk$$

To find answers and develop good policies one has to proceed to a different level of causation. To start this line of thinking I want to point out that Nunnenkamp[22] also came to the conclusion that FDI is unlikely to deliver significant growth and development effects, especially if FDI is aimed at the exploitation of natural resources and if the developing country has not a certain level of development. His empirical study point towards a positive correlation between growth and institutional factors. Findings, by Acemoglu[23], Easterly and Levine[24] as well as Rodrik[25] support Nunnenkamp hypothesis that institutions are an important explanatory variable for the differences in economic performance. All these studies come to the conclusion that long-run differences in income levels are solely determined by differences in institutional quality. The link between institutional building and economic development in its broadest sense is even reinforced by the formation of social capital and the convergence of values - currently a problem area in Namibia. Namibia specific studies[26] on how to improve the countries competitiveness regarding FDI and the business climate[27] point mainly to investment constraints that are in front of the door called: "Institutional Quality". Namibia has to improve its ranking on the following topics:

- Starting a business (rank 86 out of 175)
- Registering property (rank 127)

22 Nunnenkamp, P. 2003: " Economic Policy, Institutional Development, and Income Growth" in Kiel Working Paper No. 1183.
23 Acemoglu, D.S. Johnson, and Robinso, J.A. 2001: The Colonial Origins of Comparative Development: An Empirical Investigation. American Economic Review 91(5) p. 1369-1940.
24 Easterly, W. and Levine, R. 2002: Tropics, Germs, and Crops: How Endowments Influence Economic Development. NBER Working Paper 9106.
25 Rodrik, D., Subramanian, A, and Trebbi, F. 2002: Institutions Rule: The Primacy of Institutions over Geography and Integration in Economic Development, NBER Working Paper 9305.
26 Services Group Report, 2005: "Namibia Investor Road Map", published by USAID.
27 World Bank Group, 2006: "Doing Business 2007" Economy rankings on the ease of doing business. See also: http://www.doingbusiness.org

- Protecting investors (rank 66)
- Trading across borders (rank 144)
- And Enforcing contracts (rank 64)
- Namibia ranked 42 overall

Apart from addressing the above mentioned shortcomings, Namibia could formulate more appropriate policies for attracting FDI by doing a comprehensive investment climate survey with domestic and foreign companies.

Lastly, it is important in empirical research to analyze the costs and benefits of FDI, however, the business view on the constraints of doing business should guide policy making. In the end investment or not to invest is based on a business decisions. Government's role is to formulate policies that enough "value" flows into national development, irrespective the origin of the investment. The ultimate goal of any development path should be in Amartya Sen's[28] words the expansion of the real freedom people enjoy and to "concentrate on the capabilities of people to do things – and the freedom to lead lives – that they have reason to value". If FDI leaves enough space for "living a good life", it should be welcomed.

[28] Sen, A. 1999: Development as freedom. Oxford: Oxford University Press. p.88.

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Strategies to Promote Foreign Direct Investment in Namibia

By

Mr. Robin Sherbourne

Independent Economist

1. Introduction – How Important Really is FDI?

The role of Foreign Direct Investment (FDI) in promoting economic growth in low and middle income economies has been the subject of economic investigation for several decades. It is no exaggeration to say that economists universally agree that FDI is a vital ingredient in the policy recipe for transforming poor countries into richer ones. FDI supplements domestic savings (which are often low in poorer countries) and brings skills and technology. In fact, the importance of FDI applies equally to richer countries which accounts for the fact that even the US and UK, the world's largest and fifth largest economies, were the world's second and first greatest recipients of FDI in 2005[29]. To economists, the evidence of the past 50 years is that FDI is, almost without question, a good thing.

Namibia's short sixteen years of independence provides ample evidence that here too FDI has been an important ingredient in the Namibian economic success story. In agriculture, fishing, mining, manufacturing, construction, tourism, telecommunications, and financial services, FDI has played a vital role in some of the most dynamic sectors of the economy undoubtedly "crowding in"

much local investment with it. What would independent Namibia's growth rate have been without the presence of key major and a long list of minor multinational companies from De Beers to Telia to Wilderness Safaris? Despite the fact that many people believe Namibia's record of attracting FDI has fallen short of the expectations of those pragmatic visionaries who pushed for the early enactment of legislation to promote FDI (Namibia's pioneering but possibly now outdated Foreign Investment Act of 1990[30]), there can be no doubting the important role it has contributed to that rare phenomenon – a small African country which has achieved sustained positive economic growth for more than one-and-a-half decades.

29 UNCTAD estimates the UK attracted US$219.1 billion and the US US$106 billion of FDI in 2005 while China attracted US$60.3 billion and South Africa US$7.2 billion.

30 Foreign Investment Act 1990 (Act No 27 of 1990).

2. The Namibian Policy Environment – Not Quite So Clear Cut

Yet, as is so often the case, what starry eyed economists see as almost unambiguously positive, many non-economists view with suspicion and mistrust. In the perception of many, including some policy-makers at the highest levels of Government, foreign companies come to Namibia to exploit the country's natural resources, shipping them back to their industrialized home countries for further "beneficiation". In the process, they do their utmost to employ as few Namibians and pay as little tax locally as possible and take as much profit as they can out of the country. At the extreme, this view of the world sees investment as a zero sum game with FDI in direct competition to local investment. An investment opportunity exploited by a foreign company is an opportunity taken away from a local one. In this view of the world FDI "crowds out" rather "crowds in" local investment and is purely exploitative leaving Namibia with few if any of the benefits from the investments made. To the man on the street, there is more than enough for anti-FDI populists to point to that supports this view. Isn't it true that fishing companies continue to add more value overseas? That Namdeb's rough diamonds are all exported to the Diamond Trading Company (DTC) in London? That mining companies have paid little or no profits tax for years? That repatriated profits account for millions of Namibia dollars every year?

But the "FDI as exploitation" view of the world is a view which sees nationalistic or racist attitudes as being the main determinants of the way the world works. It is a view that ignores the prime importance of economics and the simple age-old pragmatism of the profit motive. In the vast majority of cases, multinational companies are not agents of foreign Governments or racial groupings but rather of their shareholders who are, more often than not, spread across the globe (and may even include Namibians). If it makes commercial sense to employ locals they will do so. If regulations make it easy to take money out they will be more likely to bring it in the first instance. If tax rates are competitive there will be little incentive to practice evasion or transfer pricing. Whatever the case, their prime objective is to make money for shareholders.

Namibia's position is possibly far more extreme than most countries for its economy is dominated by large foreign companies. Virtually the only large companies that are locally owned are owned by the state. This situation, perhaps, makes FDI a more sensitive issue than in other more balanced economies where local firms play a more important role in delivering economic performance. But it is probably fair to say that, with the exception of monopolies, Namibian-owned companies have fared poorly when they have not had significant foreign partners. The recent case of Ongopolo has again brought this issue into sharp relief.

3. Strategies to Improve the Investment Environment – What More Can Namibia Do?

In short, only the most gung-ho “go it aloners” would argue that Namibia does not need FDI, especially if it is to raise its historical rate of growth from the rather modest 3 percent a year to the 6 percent or 9 percent a year targeted by “Vision 2030”. What needs to be done then to attract the FDI required to achieve this?

There are no shortage of improvements to Namibia’s policy environment which, together, would form a convincing and coherent FDI strategy capable of boosting growth and employment creation.

Property rights and BEE

The issue of property rights forms the foundation of any strategy to promote FDI. Investors need to know that their investments are safe and cannot arbitrarily be snatched away by either Governments or individuals. This is especially important in Africa which has, over the decades since independence, rightly or wrongly won a reputation for insecure property rights as Governments have attempted to accelerate the indigenization of their economies by both ill and well thought out means. When foreign investors see a Government like Namibia’s cosying up to Governments which have not respected property rights and praising their methods, alarms bells start sounding. Of course a sovereign state has the right to pursue its own policies in its own ways. But this debate is not one about rights. It is one about what is likely to attract or repel investors who are not obliged to invest but will only do so out of choice.

Up to now, property rights over commercial farmland have received the lion’s share of attention since 1990. The law was changed in 1995 to prohibit the ownership of commercial farmland by foreigners[31]. Most damagingly, however, Namibia’s politicians have not succeeded in presenting a clear and unified position on the emotive issue of Zimbabwe since 2000 when the farm invasions there started, something which probably reflects deep disagreement on the issue throughout the ruling party. Two recent examples of high ranking Government politicians praising

31 Agricultural (Commercial) Land Reform Act 1995 (Act No 6 of 1995).

Zimbabwe's land reform programme have added to concerns[32]. However, despite this ambiguity, Namibia has always been careful to pursue its own land reform strategy strictly according to the Constitution and the law.

While land has been the main focus of attention, other "natural" sectors – fishing and mining – have also given rise to concerns over property rights. In 2000 the Ministry of Fisheries imposed unwanted shareholders onto fishing companies in what at the time were termed "shot gun weddings"[33]. In the mining and energy sector, the issue of foreign ownership has been slower to come to the surface, possibly because Government was a 50 percent shareholder in Namdeb and the rest of the mining sector was suffering from low prices and profitability. This year for the first time, however, Government's Medium Term Expenditure Framework (MTEF) document clearly expresses its intention to achieve 35 percent Namibian ownership across the mining and energy sector by 2008/09 and there are anecdotal reports that the Ministry is attempting to put this into practice[34]. There is, however, no formal policy or legislation to support such a process.

Inextricably linked to the issue of property rights is the issue of "black economic empowerment" or BEE. The process of drawing up a policy on BEE has dragged on for some five years within the Office of the Prime Minister (OPM) but as yet no draft policy has been presented for scrutiny by stakeholders. It is understood that the OPM is currently putting out to tender a consultancy designed to form the basis of a policy on "Transformational Economic and Social Empowerment Framework (TESEF)" or "Transformational BEE". It looks as if a national policy on BEE is still some years away. This has created an environment of uncertainty since investors do not know whether and with whom they will be required to share equity and what other obligations they are likely to face.

Strategy 1

Foreign investors seem to have accepted that land is an especially sensitive issue in southern African. Although it has the potential to be extremely destructive if handled badly, the issue of land can essentially be separated from other sectors of

32 Deputy Minister of Lands Isak Katali was quoted as saying "We also feel that if the people of Zimbabwe did this, we can do it in the same manner." The Namibian 1 June 2006 while Attorney General Pendukeni Ithana was quoted by The Herald praising Zimbabwe's land reform programme The Namibian 20 July 2006.

33 See The Namibian 12 February 2001.

34 MTEF 2006/07-2008/09 page 237.

the economy. Thus, foreign investors have continued to invest despite the ambivalent stance towards Zimbabwe demonstrated by many policy-makers at the highest levels. However, much of the rest of the world is still waiting to see if Namibia follows a similar path to Zimbabwe and a clear and unambiguous stance would do much to promote investor confidence. Aside from the question of land, the issue of BEE in general and equity sharing in particular needs to be resolved sooner rather than later. Until foreign investors know for sure whether and with whom they are required to share equity, the issue will create uncertainty and damage investor confidence.

Markets

Namibia is a small country whose population forms a very small effective market for goods and services. Most FDI considering Namibia as an investment destination is likely to look to export markets as the ultimate destination for Namibian production. It is, therefore, important that Namibia makes sure it has access to larger markets. Policy-makers have long recognized this requirement and Namibia has gone to some lengths to ensure, not only that it is a member of the World Trade Organisation (WTO) but also that it is a full and active member of the Southern African Customs Union (SACU) and the Southern African Development Community (SADC). Namibia has supported moves by SACU, now headquartered in Windhoek, to establish special trading arrangements with the US, China, India and Mercosur although of these only a Preferential Trade Agreement with Mercosur has so far been signed. Despite good intentions, regular meetings and endless resolutions, progress towards greater regional economic integration has been exceedingly slow. As a result, Namibia's patterns of trade have changed remarkably little since 1990 although China represents an important new export destination, mainly for minerals.

Strategy 2

Namibia has long recognized the importance of market access in promoting foreign investment but has generally worked with other countries to pursue this goal. Since progress has been exceedingly slow, the only other alternative is to try and pursue a unilateral policy. Namibia's small size and lack of negotiating resources may mean this alternative is less attractive than the current approach.

Taxation

Taxation is one area in which countries have considerable unilateral scope to make themselves more attractive to foreign investors. Government started to lower the corporate tax rate from 42 percent at independence to 35 percent by 1995 but has chosen not to further reduce it since. Mining companies have paid 37.5 percent since 2000. Diamond mining companies have paid 55 percent plus a 10 percent royalty on the export of rough diamonds since 1995.

Instead of lowering the corporate tax rate, Namibia has chosen to introduce a plethora of highly discretionary tax incentives for manufacturers and exporters which the Minister of Finance in her last budget speech stated were now under review[35]. The general view seems to be that these incentives have been too generous, too complex to administer and have not given rise to new investment and jobs as planned. At 35 percent Namibia's corporate tax rate is higher than most other countries in the region and at the higher end of the international spectrum, although simple comparisons may hide more complex differences in the total amount of tax companies pay[36]. Botswana and Mauritius levy a 25 percent corporate tax with further reductions for specific companies. While there may be some desire at the policy level to reduce corporate taxation, such a policy would result in very clear losses in revenue in the short-term in exchange for only very uncertain economic benefits in the very long term. Government has been struggling to increase revenue from non-mining corporate sources for some time.

Within this overall picture, considerable tax uncertainty has arisen in the mining sector with the sudden and unexpected introduction in November 2004 of a royalty tax on gross sales of between 4 percent and 5 percent on non-diamond mining companies[37]. Although the Ministry of Mines and Energy is now busy consulting mining companies on a compromise acceptable to both sides, the tax has been gazetted and made provision for by mining companies. It is currently acting as a considerable deterrent to exploration companies since the new tax has the potential to considerably reduce returns, even in the current positive climate for minerals.

Further tax uncertainty has been added by the announcement by the Minister of Finance in her budget speech that she intends to review Namibia's EPZ tax

35 Budget speech 2006/07 paragraph 70

36 KPMG's latest survey of corporate tax rates 2006 calculated average rates of 25.04percent in the EU, 29.99 percent in the Asia-Pacific region and 28.25percent in Latin America see www.kpmg.com.

37 See Notice 248 in the Government Gazette No.3322

incentives[38]. These, it is believed, have been far too generous and extended to investments that probably would have gone ahead anyway. It is not clear how existing beneficiaries will be dealt with if it is decided to change or scrap the scheme.

Strategy 3

It does not appear that Namibia now has the appetite to use the issue of taxation to aggressively promote FDI. Such an approach seems to have been discredited with only mixed results from the EPZ programme and manufacturing incentives. Indeed, if anything Government appears to be preparing to do away with existing incentives and raising new taxes on a key sector of the economy. Although tax is neither the only nor the most important factor for foreign investors in reaching their investment decisions, it is an important one and one which can be changed relatively easily compared to other policies. Promoting a credible, competitive and comprehensive long-term tax strategy could be a useful element within any strategy to promote FDI. This will require a change in approach and a more regular assessment of tax regimes in other countries.

Transfer pricing

Linked to the issue of taxation is that of transfer pricing. As far as is known no serious research has been done on this issue in Namibia yet it is commonly assumed to be a widespread phenomenon by senior policy-makers. However, it is likely that the incentive for companies to practice transfer pricing will rise if Namibian tax rates are uncompetitive with those of other countries and if the chances of being caught are small.

Strategy 4

It is unlikely that transfer pricing can be eliminated altogether but Namibia can minimize the likelihood of transfer pricing taking place by ensuring its tax rates are competitive and its enforcement of tax compliance is effective.

Capital controls

Namibia's Foreign Investment Act of 1990 cemented the rights of foreign companies to repatriate their profits abroad. Foreign companies pay a 10 percent

38 See Budget Speech 2006/07 paragraph 70 "The existing incentive schemes are currently under review."

Non-Resident Shareholders' Tax (NRST) on dividends to shareholders outside the country. Otherwise capital movements into and out of the country are governed by CMA regulations which have over the past 16 years been considerably liberalised, albeit in a "gradual and phased" way rather than through a "big bang". The South African Government has stated its commitment to a "gradual process of exchange control liberalisation that takes into account critical sequencing considerations". According to Finance Minister Trevor Manuel "a sustainable development path requires that certain conditions be in place before proceeding to full capital convertibility."[39]

The orthodox view on capital controls has long been that the easier it is to take money out of a country the more likely investors will bring it in the first place. This orthodoxy has been challenged since the late 1990s and the need for "speed bumps" has become accepted wisdom in order to attenuate the completely free flow of money and reduce speculative short-term flows which can prove so damaging to small economies.

Strategy 5

The scope for unilaterally accelerating further liberalization of capital controls should be investigated but Namibia is unlikely to be able to pursue such a policy much faster than neighbouring South Africa.

Labour

One of the most perplexing characteristics of economic development since independence has been the fact that, while Namibia's economy has grown, it has not created jobs, certainly not formal sector jobs[40]. The reasons for this have been the subject of several investigations. The lack of new jobs appears to have come about thanks to a combination of a poor public education system which fails to provide workers with the skills and training required by the economy coupled with employment legislation which imposes significant costs on employers when they take on labour[41]. Affirmative action employment legislation has recently been changed to apply to employers of 25 workers rather than the previous 50 despite

39 Closing remarks to the Commission of Enquiry into the Rapid Depreciation of the Exchange Rate of the Rand and Related Matters, 24 May 2002.

40 See the Population and Housing Census of 1991 and 2001 and the Namibia Labour Force Surveys of 1997, 2000 and 2004.

41 See "Namibia Human Capital and Knowledge Development for Economic Growth with Equity" published in February 2005 by the World Bank.

the fact that a large proportion of larger companies have not complied[42]. The upshot is that few if any foreign companies come and invest in Namibia because of its workforce.

The generally held but unstated view among Namibian policy makers seems to be that foreign labour crowds out local employment. Many investors would argue the precise opposite: that, without access to the skills they need abroad, an investment might not be worth pursuing and this reduces opportunities for local labour. Indeed it may even be a disincentive as employers are increasingly caught between being prevented from taking on skilled foreign workers and being obliged to take on badly educated local workers with few skills and little training knowing that employment law will make it difficult to get rid of when they prove unproductive. The conundrum is exacerbated by a free rider problem which prevents employers from devoting more resources to skills and training out of fear that they will be poached by other employers who have not made the required investment.

Strategy 6

If Namibia expects foreign investment to contribute towards employment creation, policy must ensure it pays investors to employ Namibian labour. By making it harder to employ skilled foreign labour without first ensuring a sufficient supply of skilled and motivated local labour, policy reduces competition in the labour market and drives up the cost of local labour. It is local unskilled labour that then suffers most since skilled Namibians can command virtually any price even in the labour market. There is little prospect that a sudden improvement in the quantity and quality of skilled Namibian workers will take place any time soon. However, a relaxation of restrictions on foreign labour would help improve the competitiveness of the local labour market and have a beneficial effect on overall employment.

Infrastructure

Namibia generally scores well in international comparisons of infrastructure but this positive outlook has recently clouded as it becomes increasingly clear that

electricity supply is likely to act as a significant brake on growth over the coming five years. Namibia has traditionally relied on South Africa for much of its electricity supply. Overcapacity created during the apartheid years meant that South Africa

42 See The Namibian 12 July 2006.

could export electricity far more cheaply from Eskom's predominantly coal-fired power stations than it would cost Namibia to produce itself. However, higher than expected economic growth combined with poor planning and an unclear policy framework in South Africa means that this is no longer the case. The termination of Namibia's Power Purchasing Agreement (PPA) with South Africa this year heralded the start of a period of considerable uncertainty for power consumers in Namibia which does not look like being resolved until 2010 at the earliest. According to NamPower, electricity prices are set to at least double[43]. This will act as a handicap on the mining sector and on the potential to expand copper smelting and refining.

Strategy 7

Namibia's most viable solution to the looming energy crisis is Kudu gas-to-power which has the potential both to supply the local energy market and to turn Namibia into a significant exporter of electricity. The Final Investment Decision on Kudu, however, remains some way off due to disagreements between partners NamPower and Energy Africa on the Gas Sales Agreement as well as the Power Purchasing Agreement between NamPower and Eskom. Despite being designated a "project of national importance", Kudu is unlikely to come on stream before 2010. In the meantime NamPower appears to be toying with the idea of a 400MW coal-fired power station at Walvis Bay[44]. Namibia can promote FDI by setting out a clear energy strategy which is credible with investors.

Regulation

Since 2003 the World Bank has conducted an annual comparison of business regulations across countries. Doing Business in 2006 attempted to provide objective measures of business regulations and their enforcement in 155 countries. The Doing Business website[45] allows anyone to compare any country with regional and Organisation of Economic Cooperation and Development (OECD) averages. In virtually all areas, Namibia comes out far better than the sub-Saharan average but generally worse than the OECD average. However, whereas it takes 85 days to launch a business in Namibia, it takes only 63 days in the region and only 25 days in the OECD. There is clearly room for progress.

43 See The Namibian 29 May 2006.
44 See The Namibian 24 July 2006.
45 See www.doingbusiness.org.

Strategy 8

A strategy to increase FDI should take account of business regulations and carefully monitor Namibia's regulatory environment making regular comparisons with other countries.

Finance

FDI often brings its own money with it and therefore rarely taps local Sources of finance. The Namibian Stock Exchange (NSX) has no listings where foreign companies have sought to raise money locally. The Development Bank of Namibia (DBN) has not lent to any foreign companies in its first full year of operation. The Minerals Development Fund (MDF) has no restriction on funding foreign-owned initiatives. FDI, however, presents Namibia with an important dilemma which has yet to be resolved. On the one hand policy wants to encourage FDI to bring its own money with it in order to supplement local savings. On the other hand it wants to encourage Namibian involvement and shareholding which suggests Namibian money should also be made available.

Strategy 9

One way Namibians can play a greater role in major investments and become genuine partners in FDI projects is if they can help fund investments. Namibian institutions such as the DBN, NSX and MDF as well as private banks and equity funds should gear their activities to enable this to take place.

Public sector efficiency

Namibia has one of the largest public sectors anywhere in the world in proportion to its size yet in many ways appears to be one of the least efficient. Although some foreign investors will end up having minimal contact with Government, most will have protracted dealings with Government over licences, rights, taxation and regulations. The Investor Road Map[46] produced recently for the Government sets out improvements that could be made to ensure investors, foreign investors among them, are dealt with more effectively. The final document has not been made widely available.

[46] Investor Road Map produced by The Services Group and financed by USAID.

Strategy 10

A strategy to promote FDI should include the implementation of the recommendations of the Investor Road Map. This requires the serious attention of policy-makers and significant regular monitoring to ensure it takes place.

Corruption

A spate of studies over the past ten years has established that corruption has a clear and negative effect on economic growth[47]. Namibia has started to slide down the rankings of one of the best known international comparisons of corruption produced by Transparency International (TI)[48]. In 2001 Namibia was ranked 30 out of 91 countries but by 2004 this had fallen to 54 out of 145 countries. The year 2005 saw a slight improvement to 47 out of 158 countries as TI gave Namibia credit for establishing the long-awaited Anti-Corruption Commission. Namibia's lower position has come about due to a reduction in its absolute Corruption Perceptions Index (CPI) score rather than the increase in the sample size and this is cause for concern. Newly elected President Pohamba vowed to tackle corruption but there is little concrete sign so far that this is being seriously addressed.

Strategy 11

Namibia can successfully tackle corruption by releasing documents relating to past investigations into corrupt practices and focusing the work of the Anti-Corruption Commission on the larger more damaging cases of corruption rather than on "small fish" who can be more than adequately dealt with by other bodies. The media should be actively encouraged to investigate corruption cases and people should be held to account for their misdoings regardless of position.

Competitiveness

As with corruption, Namibia has slid down international rankings of competitiveness. In the World Economic Forum's (WEF) latest assessment in 2005 Namibia was ranked 63 out of 117 countries compared to 53 out of 80 countries in 2002[49]. The WEF states that the fall was driven by "lower assessments of bureaucracy, favouritism of Government officials, and corruption" underlining concerns expressed within Namibia during the past year that corruption might be

47 See Daniel Kaufman in the Global Competitiveness Report 2005 published by the World Economic Forum.
48 See www.transparency.org
49 See www.weforum.org

harming the country's reputation as a good place to invest. Namibia is ranked even worse in the Business Competitiveness Ranking at 73, only just above Nigeria at 76. Namibia comes in at 57 in the Public Institutions Index just below China. From consistently coming fourth in Africa, Namibia now comes sixth behind South Africa, Botswana, Mauritius and, for the first time, Ghana and Egypt.

Strategy 12

Attracting FDI involves cultivating a positive international image. Namibia appears to take little notice of the international reports written about it and puts little effort into actively projecting information that would help improve its image as an investment destination. It may be the case that Government sponsored promotion campaigns have little impact on sceptical investors who are far more interested in how things really are and hearing from a free media and the experiences of actual investors. But Government should regularly take stock of the reports being written about it by a variety of credible international institutions including the World Bank, the IMF, the World Economic Forum, Transparency International, and the Economist Intelligence Unit.

Information

Investors require significant amounts of credible and reliable information but this is not always easy to come by in Namibia, even when it exists. No proper study has been conducted on this issue so it is impossible to reach firm conclusions. However, few would disagree that there is not yet a culture of publishing information and data in a timely way and making it accessible on the Internet. Often information is available but not accessible. Other times it is prevented from being made accessible by knee-jerk bureaucratic hurdles. Often requests for the least confidential information will be met with responses requiring the approval of a Minister or Permanent Secretary. Government websites are generally amateurishly constructed and badly maintained[50]. It is virtually impossible to conduct business with Government agencies by email or over the Internet. Government's email system is often down and many in Government are not properly acquainted with modern systems of communication. Key documents, from the recently prepared Investor Road Map to major pieces of draft legislation, are only available to those in the know.

50 See, for example, www.grnnet.gov.na

Strategy 13

Providing information is generally not expensive. It is largely a question of attitude. Currently Namibia seems split between those who believe the release of information constitutes a threat that must be countered at any cost and therefore release as little information as possible and those rather more enlightened individuals and organizations that believe the more information that is available the better. A strategy to promote FDI should also help tilt things in favour of the latter. Constructive engagement with a free press, the more active use of electronic media and the Internet, the employment of genuine, useful and user friendly public relations officials and the timely release of Government and parastatal reports could do much to provide more of the information foreign investors would find useful.

4. Conclusion – a comprehensive and coherent way forward

This short paper has identified a clear and critical list of measures which Government could take if it wanted to boost FDI in Namibia: securing property rights, improving market access, creating a clear and competitive system of taxation, providing skilled and productive labour, working towards the free flow of capital, constructing world class infrastructure, eliminating corruption, cultivating a positive international image, and producing credible and timely information. A useful supplement to all this would be to carry out a regular survey of FDI in Namibia to hear the views and experiences of those who have actually invested, preferably conducted by an independent agency to enhance credibility. If positive, such a survey could turn out to be one of the best advertisements for the country in a world which offers increasing choice to so many investors. Government can do many things to promote FDI but in the end investors will only come if it pays them to do so. And the only test of any strategy that counts is whether more FDI actually materializes.

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Comments On Strategies To Promote Foreign Direct Investment In Namibia

BY

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BACKGROUND

My comments are focused on the paper prepared by Robin Sherbourne for this symposium. I was probably invited by the organizers because of my interest in the subject, being former Head of the Namibia Investment Centre from 1998 to 2003 and continuing to be involved in my capacity as the CEO of the Development Bank of Namibia. My comments are principally drawn from this experience, but also from my humble collection of thoughts based on reading, and as a graduate of development economics.

COMMENTS

1. How important is FDI?

Robin Sherbourne begins his paper with a global perspective on FDI and by way of mention of a few investments, concludes that “there can be no doubting the important role FD has contributed to the rare phenomenon - a small African country which has achieved sustained positive economic growth for more than one and a half decades”.

I partially agree with Mr. Sherbourne’s conclusions. But I believe they could have been substantiated by a brief statistical review of the Namibian situation. The paper also conspicuously omits any specific reference not to mention analysis of the importance of domestic investment. This is disappointing because more often than not, the critical role domestic investment plays is downplayed and thus under-estimated. I remember that many were surprised when in 2003 when the first (and only) Investor of the Year award was held, local companies proved to be a considerable force to be reckoned with in judging the winners, who were rated on a number of criteria that are very important to the country. These included the value addition to the economy in terms of jobs, goods and services, foreign exchange earnings, social investment responsibility, and so on. Of the winners in the six categories considered, only two were majority foreign owned; and these were joint ventures with domestic capital. Thus, it would be more realistic to look at both domestic and foreign capital as necessary and in most cases complimentary.

Domestic investment has an important role to play in the Namibian economy. Local companies invest in ventures that often do not arouse the interest of their foreign counterparts. They also invest in key sectors of the Namibian economy such as agriculture, fisheries, services, retail and tourism. Domestic investment has a better appreciation of local conditions and therefore not as easily swayed to disinvest. It is perhaps also not fully appreciated that reinvestment by domestic capital is more natural and can be influenced by factors beyond the business arena. The Ohlthaver & List Group of Companies, Frans Indongo's Continental Group of Companies, United Africa, Woermann & Brock Wecke & Voigts, Pupkewitz, Nakara, Meatco, Diaz Fishing, Etale, Mathew Hamutenya's Millennium Investments, to name a few, are but some of the local luminaries who have made meaningful reinvestments into the economy.

On the other hand, foreign capital also plays a significant role. By virtue of its ability to access massive capital, technology, international markets, and specialized skills, foreign investment should be seen as a complimentary necessity. Without doubt, a number of sizeable projects in the mining, fishing, tourism and other sectors would not have been realized if there was no foreign investment involved. In 2000/2001, I witnessed with a sense of awe, the astonishingly fast development of the US$454 million dollar (N$3.3 billion at today's foreign exchange rate) Skorpion project by Anglo Base.

But, foreign direct investment becomes more meaningful and has greater impact when forward and backward linkages are created within the wider economy. It is unhealthy for FDI projects to become islands unto themselves. Linkages by local companies with these projects can result in increased economic activity, skills transfer and most importantly, job creation.

2. The Namibian Policy Environment

One of the first pieces of legislation after independence was the Foreign Investment Act of 1990. The Act breathed meaning into the provision of Article 99 of the Namibian Constitution which stipulates that "foreign investments shall be encouraged subject to the provisions of an Investment Code to be adopted by

Parliament". It spells out the rights and obligations of foreign investors, principally protects them and provides a framework for redress in the case of grievances. These stipulations have, since its enactment, been consistently honoured.

The Government of the Republic of Namibia has at all times reiterated its welcome of foreign investment. Both the Founding President Nujoma and the incumbent President Pohamba have reiterated their positive position on this. During his inaugural address, for example, President Pohamba stated that: "I wish to pay tribute also to the business community. Their business activities not only bring in revenue needed for national sustenance and development but also employment and income to Namibian workers. The good relations that existed between the business community and the SWAPO Party Government, under the leadership of my predecessor, will be cemented and strengthened to ensure the building of a strong economy for the benefit of the whole country".

3. Strategies to Improve the Investment Environment - What more can Namibia do?

Property Rights and BEE

The rights to property are provided for under Article 16 of the Namibian Constitution. Furthermore, Government's policy of willing-seller, willing-buyer in respect of land has been honoured. Notwithstanding these provisions of the Constitution and the said policy, Article 23 (2) in the Constitution, part of the Fundamental Human Rights and Freedoms, reads as follows: "Nothing contained in Article 10 hereof shall prevent Parliament from enacting legislation providing directly or indirectly for the advancement of persons within Namibia who have been socially, economically or educationally disadvantaged by past discriminatory laws or practices, or for the implementation of policies and programmes aimed at redressing social, economic or educational imbalances in the Namibian society arising out of past discriminatory laws or practices, or for achieving a balanced structuring of the public service, the police force, the defence force, and the prison service". (Article 10 deals with Equality and Freedom from Discrimination). The Constitution therefore recognizes the peculiar circumstances emanating from the legacy of apartheid. It would only be fair that investors recognize this historic reality. And it is in this Constitutional spirit that BEE should be seen. What is crucial is that BEE should be fair and implemented in a transparent manner. I agree that finalisation of Namibia's BEE policy (which should be speedily finalised) will augur well for investors insofar as certainty is concerned.

In a democracy, divergent views will obviously be expressed on different matters that lend themselves for public comment. I therefore, don't see how Government could come up with a policy to prevent politicians from commenting in their own capacities on various regional and international matters, including Zimbabwe.

Markets

Market access is a very essential element in promoting investment. This is especially vital for economies with limited buying power. Namibia currently enjoys market access to the European Union through the Cotonou agreement, to the US market through the Africa Growth and Opportunity Act, to Southern Africa through SACU and SADC, to Latin America through the SACU-MERCOSUR trade arrangement. SACU is also negotiating with India and China on preferential market access. The unilateral route would be difficult to pursue due to limitations placed on Namibia by virtue of its SACU membership as its external tariffs are binding on all members.

Taxation

Consistency in the fiscal regime and in particular in the framework of taxation is essential for building the confidence of both domestic and foreign investors. However, this does not mean that reform of this sensitive area should not be conducted. It is natural that amendments are effected from time to time to respond to new realities as they emerge. This has happened in the past and has proved to benefit investors; examples being the lowering of the corporate rate from 42percent to 35percent and similar lowering of the tax rate for manufacturers to 18percent on a straight line basis for a period of ten years. I agree with Sherbourne that "promoting a credible, competitive and comprehensive long term tax strategy could be a useful element within any strategy to promote FDI". I believe that investors are prepared to pay tax, but that this must leave them in a position in which they are still competitive. Considering the competitive nature of investment promotion both regionally and internationally, it is imperative that a comparative position is taken in our reviews on the issue. It is also important to bear in mind that taxation can be an important instrument to encourage reinvestment, stimulating the interest of existing investors who are known and proven entities. Similarly, the tax regime must be supported by an efficient and effective institutional mechanism as effective administration of the system is just as important as the regime itself.

Transfer Pricing

I agree with Sherbourne that transfer pricing may be better combated by making it attractive to declare taxation here because of the competitive tax regime. The institutional mechanism must also be appropriately resourced to be able to be effective.

Capital Controls

Capital movement is an important consideration by foreign investors. There must be adequate assurance that investors are able to move capital fairly easily, within reasonable limits. This becomes more pronounced should deterioration of the investment climate be apparent; exemplifying the need to maintain a competitive business environment. I doubt whether it will be prudent to pursue a unilateral position on liberalization considering our membership to the Common Monetary Area.

Labour

I agree with Mr. Sherbourne on his strategy for labour. A pragmatic approach is necessary in respect of the skills required to run businesses on a sustainable basis. It is no secret that even those countries that have excelled in industrial development have pursued strategies of welcoming foreign labour in areas where they experience a shortage of skills. In Namibia, this strategy could be discredited should unskilled labour be brought in under the guise of plugging the skills gap, and serve to discourage companies from building Namibian capacity.

There should indeed be incentives for companies to upgrade their workforce's skills; and the current incentives for manufacturers have taken this into consideration. The national education system should also be geared towards the provision of relevant skills, at all levels as a key consideration of investors is the skill base available. If for example, Namibia is able to boast skills in electronics, it will be easier to attract companies to invest in that area of activity.

Productivity and discipline are other important considerations. It is perhaps difficult to develop a policy on these matters, but a culture in this regard could be encouraged and nurtured through the unions and shop stewards in particular. It is a process that involves incentives, appreciation of the need to be competitive and strong persuasive abilities.

Infrastructure

One of the factors that contribute to a conducive environment for business to operate is good infrastructure. Reliable road, rail, telecommunication, port, water, power and related services enhance the efficiency of businesses.

I agree that in the short to medium term, drastic steps need to be put in place to ensure the reliability of power supply. The nation needs to be reassured that steps are being taken to keep the country alight at all times. I know that Nampower is working flat out to ensure this. Obviously, major investments are required to develop new Sources of power. It is perhaps time to consider Nampower as an entity that could generate its own funds through debt facilities and possible unbundling. The recent Fitch positive rating for Nampower has greatly enhanced the company's position in the market.

Regulation

Yes, regular comparisons with other countries in terms of regulations are necessary. I also believe that there is a need for a proactive approach in terms of regular self assessment and the effective use of technology. Revolutionary solutions could be put in place in the company registration office, immigration, customs and other public institutions, where what currently takes days (even weeks), could take minutes; and improve the reliability of data gathering and management.

Finance

I agree that financial institutions should continuously improve on their product offerings. I am confident that financial institutions currently have the capacity to participate in a range of bankable projects. I don't see any reason why DBN or any other financial institution cannot finance a project which is viable and has bona fide promoters. I know that the DBN is interested in financing Namibian participation in projects; and there should be more funds available in the market once the amendment to regulation 28 requiring asset managers to invest more in unlisted companies comes into play. And will certainly require some more creative approaches to be employed in the deployment of such funds.

Public Sector Efficiency

The Investor Road Map has made some recommendations that could improve service delivery to the business community. I also believe that a performance management system should be introduced in the public service. Such a system should have measurable targets. It could be introduced gradually starting with the senior management. Those who meet targets should be rewarded.

Corruption

I do not doubt the Government's will to combat corruption. The establishment of the Anti Corruption Commission and the Ombudsman's Office are important developments that should be respected, supported and given the required resources to execute their responsibilities. The fight against corruption is a process, not an event. It is also a sensitive exercise which should be handled with care and maturity and be seen to be executed with the required high level of integrity; otherwise the process will be discredited.

Competitiveness

I agree that it is imperative that the management of Government information and public relations be made more robust and sophisticated, to ensure that the public and the business community is suitably informed. It is also important to establish a network of contacts internationally and with the various rating agencies, through economic diplomacy and the establishment of relationships with these rating agencies.

It would be worthwhile to evaluate these reports to see how best to improve in the future. This process could involve various stakeholders. The President's Economic Advisory Council could add immense value in this regard. The reports should be welcomed as an opportunity to improve service delivery.

Information

Technological advances have made it possible to communicate more efficiently. Through effective use of electronic communications, it is possible to reach news media both here and abroad. The beauty with this is that it is effective and cost effective. All it takes is to work smart and stay on message. The management and presentation of information is indeed critical to successful investment promotion.

4. CONCLUSION

I agree with the conclusion that a regular survey of FDI in Namibia should be carried out. Such a survey would help policy makers to improve on areas that require attention.

In addition, I would like to also propose that an Investment Advisory Council consisting of various stakeholders be established to advise the Minister of Trade and Industry and Government on matters pertaining to investment promotion.

It is important that domestic investment is also recognized and encouraged through the tax regime and other measures to reinvest in the country.

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Conclusions and Issues Emanating from the Symposium

Research Department,
Bank of Namibia

CONCLUSIONS

The symposium underscored the fact that FDI supplements domestic investment and brings along organizational and managerial skills, new production technology, and sometimes market access and thus stimulating employment, exports, and overall economic development. The effect of FDI on growth could also be of a dynamic nature in that there are two rounds of effect viz. a competition effect for domestic enterprises in the industry of the foreign entrant that is generally negative, and a subsequent round which could include a usually favorable externality on domestic investment because of backward linkages. Moreover it was also established that in Namibia, FDI crowds in domestic investment rather than squeezing it out, thus supporting the process of capital formation. In addition, the direction of causation was found to be running from growth to FDI, i.e. the growth rate of the economy is a signalling mechanism for FDI. However, it was stressed that if not well addressed in our overall industrial policy framework, FDI could pose some challenges to the local economy.

Since there is evidence to prove that FDI stimulates domestic investment, it is crucial for policy makers to devise an alternative policy strategy emphasizing domestic investment as a key to stimulate economic growth, development and industrialization. More specifically, this strategy should focus on how to efficiently utilise domestic investment in the medium to long term in order to improve infrastructure, developing human resources, entrenching local entrepreneurship, and realising the full potential of what our economy can offer.

More specifically, the symposium suggested the following policy strategies to improve the investment environment in Namibia.

Property rights and BEE

The issue of property rights forms the foundation of any strategy to promote FDI. Investors need to know that their investments are safe and cannot arbitrarily be snatched away by either governments or individuals. Inextricably linked to the issue of property rights is the issue of “black economic empowerment” or BEE. The process of drawing up a policy on BEE has dragged on for some five years within the Office of the Prime Minister (OPM) but as yet no draft policy has been presented for scrutiny by stakeholders. Aside from the question of land, the issue of BEE in general and equity sharing in particular needs to be resolved sooner rather than later.

Markets

Namibia has long recognized the importance of market access in promoting foreign investment but has generally worked with other countries to pursue this goal. Since progress has been exceedingly slow, the only other alternative is to try and pursue a unilateral policy. Namibia's small size and lack of negotiating resources may mean this alternative is less attractive than the current approach.

Taxation

Taxation is one area in which countries have considerable unilateral scope to make themselves more attractive to foreign investors. It does not appear that Namibia now has the appetite to use the issue of taxation to aggressively promote FDI. Namibia should promote a credible, competitive and comprehensive long-term tax strategy to promote FDI. This will require a change in approach and a more regular assessment of tax regimes in other countries.

Transfer pricing

Linked to the issue of taxation is that of transfer pricing. It is unlikely that transfer pricing can be eliminated altogether but Namibia can minimize the likelihood of transfer pricing taking place by ensuring its tax rates are competitive and its enforcement of tax compliance is effective.

Capital controls

Namibia's Foreign Investment Act of 1990 cemented the rights of foreign companies to repatriate their profits abroad. Foreign companies pay a 10 percent Non-Resident Shareholders' Tax (NRST) on dividends to shareholders outside the country. The scope for unilaterally accelerating further liberalization of capital controls should be investigated but Namibia is unlikely to be able to pursue such a policy much faster than neighbouring South Africa due to the CMA arrangement.

Labour

One of the most perplexing characteristics of economic development since independence has been the fact that, while Namibia's economy has grown, it has not created jobs, certainly not formal sector jobs. If Namibia expects foreign investment to contribute towards employment creation, policy must ensure it pays investors to employ Namibian labour. By making it harder to employ skilled foreign labour without first ensuring a sufficient supply of skilled and motivated local labour, policy reduces competition in the labour market and drives up the cost of local labour. Namibians can command virtually any price even in the labour market. There is little prospect that a sudden improvement in the quantity and quality of skilled Namibian workers will take place any time soon. However, a relaxation of restrictions on foreign labour would help improve the competitiveness of the local labour market and have a beneficial effect on overall employment.

Infrastructure

Namibia generally scores well in international comparisons of infrastructure but this positive outlook has recently clouded as it becomes increasingly clear that electricity supply is likely to act as a significant brake on growth over the coming five years. Namibia has traditionally relied on South Africa for much of its electricity supply. Namibia's most viable solution to the looming energy crisis is Kudu gas-to-power which has the potential both to supply the local energy market and to turn Namibia into a significant exporter of electricity. The Final Investment Decision on Kudu, however, remains some way off due to disagreements between partners NamPower and Energy Africa on the Gas Sales Agreement as well as the Power Purchasing Agreement between NamPower and Eskom. Despite being designated a "project of national importance", Kudu is unlikely to come on stream before 2010. Namibia can promote FDI by setting out a clear energy strategy which is credible with investors.

Regulation

Since 2003 the World Bank has conducted an annual comparison of business regulations across countries. Doing Business in 2006 attempted to provide objective measures of business regulations and their enforcement in 155 countries. A strategy to increase FDI should take account of business regulations and carefully monitor Namibia's regulatory environment making regular comparisons with other countries.

Finance

FDI often brings its own money with it and therefore rarely taps local sources of finance. One way Namibians can play a greater role in major investments and become genuine partners in FDI projects is if they can help fund investments. Namibian institutions such as the DBN, NSX and MDF as well as private banks and equity funds should gear their activities to enable this to take place.

Public sector efficiency

Namibia has one of the largest public sectors anywhere in the world in proportion to its size. A strategy to promote FDI should include the implementation of the recommendations of the Investor Road Map. This requires the serious attention of policy-makers and significant regular monitoring to ensure it takes place.

Corruption

A spate of studies over the past ten years has established that corruption has a clear and negative effect on economic growth. Namibia can successfully tackle corruption by releasing documents relating to past investigations into corrupt practices and focusing the work of the Anti-Corruption Commission on the larger more damaging cases of corruption rather than on "small fish" who can be more than adequately dealt with by other bodies. The media should be actively encouraged to investigate corruption cases and people should be held to account for their misdoings regardless of position.

Competitiveness

As with corruption, Namibia has slid down international rankings of competitiveness. In the World Economic Forum's (WEF) latest assessment in 2005 Namibia was ranked 63 out of 117 countries compared to 53 out of 80 countries in 2002. Attracting FDI involves cultivating a positive international image. Namibia appears to take little notice of the international reports written about it and puts little effort into actively projecting information that would help improve its image as an investment destination. It may be the case that Government sponsored promotion campaigns have little impact on sceptical investors who are far more interested in how things really are and hearing from a free media and the experiences of actual investors. But Government should regularly take stock of the reports being written about it by a variety of credible international institutions including the World Bank, the IMF, the World Economic Forum, Transparency International, and the Economist Intelligence Unit.

Information

Investors require significant amounts of credible and reliable information but this is not always easy to come by in Namibia, even when it exists. No proper study has been conducted on this issue so it is impossible to reach firm conclusions. Providing information is generally not expensive. It is largely a question of attitude. Currently Namibia seems split between those who believe the release of information constitutes a threat that must be countered at any cost and therefore release as little information as possible and those rather more enlightened individuals and organizations that believe the more information that is available the better. A strategy to promote FDI should also help tilt things in favour of the latter. Constructive engagement with a free press, the more active use of electronic media and the Internet, the employment of genuine, useful and user friendly public relations officials and the timely release of Government and parastatal reports could do much to provide more of the information foreign investors would find useful.